BAHAN AJAR
AKUNTANSI KEUANGAN MENENGAH I

Dekeng Setyo Budiarto, Dr. Ak, CA

FAKULTAS BISNIS
UNIVERSITAS PGRI YOGYAKARTA
2024

FINANCIAL REPORTING & ACCOUNTING STANDARD

Dekeng Setyo B, Dr, Ak, CA

LEARNING OBJECTIVES

- After studying this chapter, you should be able to:
- Describe the global financial markets and their relation to financial reporting
- Identify the objective of financial reporting
- Explain the major policy-setting bodies & their role in the standard setting process
- Describe the challenges facing financial reporting

LEARNING OBJECTIVES

- After studying this chapter, you should be able to:
  - Describe the global financial markets and their relation to financial reporting
  - Identify the objective of financial reporting
  - Explain the major policy-setting bodies & their role in the standard setting process
  - Describe the challenges facing financial reporting

Preview of chapter

Financial reporting & accounting standards

GLOBAL MARKETS
- financial statement & financial reporting
- Accounting & capital allocation
- Hihg quality standard

OBJECTIVE OF FINANCIAL REPORTING
- General purpose financial statement
- Equity investors & creditors
- Entity perspective
- Decision usefulness

STANDARD-SETTING ORGANIZATIONS
- IOSCO
- IASB
- Hyrarchy of IFRS

FINANCIAL REPORTING CHALLENGES
- Political environment
- Expectation gap
- Significant financial reporting issues
- International convergence

Global market

- Keywords: international trade, investment, capital allocation, financing decision

Global market

Financial statement & financial reporting

- Financial accounting: is the process that culminates in the preparation of financial report relative to the enterprise as a whole for use by parties both internal & external to the enterprise
- Managerial accounting: process of identification, measurement accumulation, analysis, preparation, interpretation, & communication of financial information used by management to plan, evaluate, and control within organization, and to assure appropriate use of, and accountability for it resources
- Financial statement: the principals mean through which financial information is communicated to those outside an enterprise: the statement of financial position; the income statement; statement of cash flows; statement of change in equity
- Financial reporting: other than formal financial statement

The essential characteristic of accounting are:

- The identification, measurement, and communication of financial information about;
- Economics entities
- Interest parties

Accounting & capital allocation

- Accountant must measure performance accurately & fairly on a timely basis, so that the right managers & companies are able to attract investment capital.
- Relevant financial information that faithfully represents financial result allows investors & creditors to compare the income & assets employed by companies

Accounting & Capital allocation

- Resources are limited
- Accounting profesion make them effectively & efficient

Financial reporting:

The financial information a company provides to help users with capital allocation decision about the company

Users:

Investors & creditors use financial report to make their capital allocation decisions

Capital allocation:

The process of determining how & at what cost money is allocated among competing interest

High Quality standards

- Single set of high quality accounting standards established by single standards setting body
- Consistency in application and interpretation
- Common disclosures
- Common high quality auditing standards & practices
- Common approach to regulatory review & enforcement
- Education & training of market participant

High quality standards

- To facilitate efficient capital allocation, investors need relevant information & faithfully representation of that information to enable them to make comparisons across border.
- The 5 largest telecommunication companies in the world in descending order of revenue size are AT & T (USA), Verizon Communication (USA), Nippon Telephone (JPN), Deutsche Telecom (DEU), Telefonica (ESP). How do you compare?

OBJECTIVES OF FINANCIAL REPORTING

- Useful to those making investment and credit decisions who have reasonable understanding of business and economic activities
- Helpful to present and potential investors & creditors in other user in assessing the amount, timing & uncertainty of future cash flows
- About economic resources, the claims to those resources, and the changes in them

Objective of financial reporting

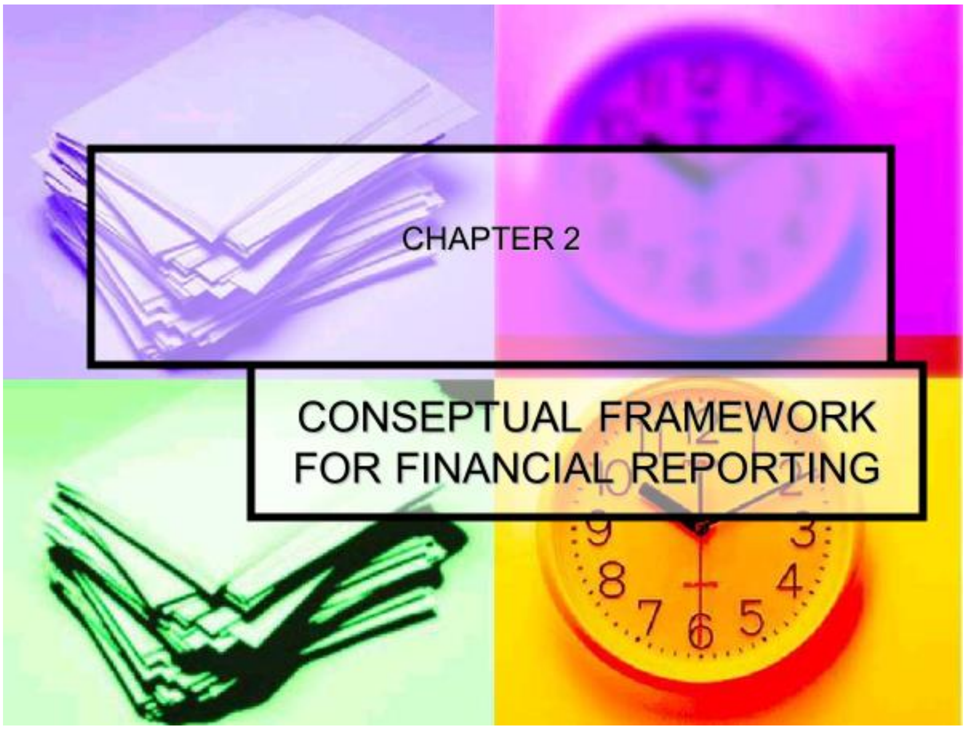
- General purpose financial statement:
  - To provide financial reporting information to a wide variety of users
- Capital providers (investors)
  - The objective of financial reporting identifies investors as the primary user group for general purpose financial statement.
- Entity perspective
  - companies are viewed as separate & distinct from their owners using this perspectives
- Decisions usefulness
  - Ability to generate net cash inflows
  - Ability to protect & enhance the capital providers' investment

Standard-setting organization

- For many years, many nation have relied on their own standard-setting organization
- One organization is based in London is called International Accounting Standard Board (IASB)
- IASB issues international Financial Reporting Standard (IFRS)
- The other standard-setting organization is the Financial Accounting Standards Board (FASB), which is based in the USA
- The two organizations that have a role in international standard-setting are the International Organization of Securities Commissions (IOSCO) & IASB

Financial reporting Challenges

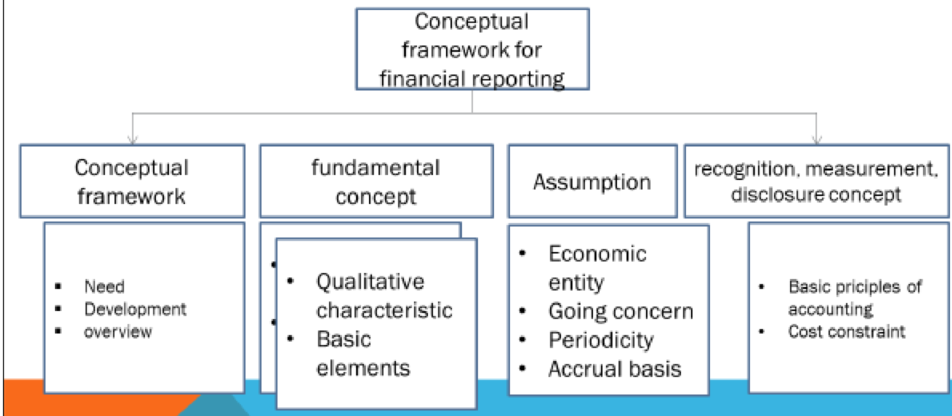
- IFRS in political environment
- The expectation gap
- Significant financial reporting issues
- Ethics in the environment of financial accounting
- International convergence



LEARNING OBJECTIVES

- Describe the usefulness of a conceptual framework
- Identify the qualitative characteristics of accounting information and tha basic elements of financial statement
- Describe the basic assumptions of accounting
- Explain the application of the basic principles of accounting

PREVIEW OF CHAPTER 2



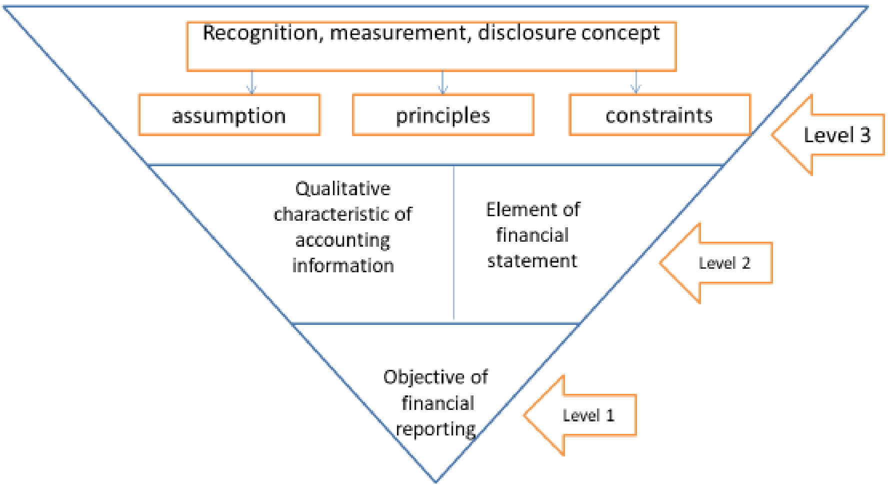
NEED FOR A CONCEPTUAL FRAMEWORK

Why do we need a conceptual framework?

First, to be useful, rule-making should build on and relate to an established body of concept

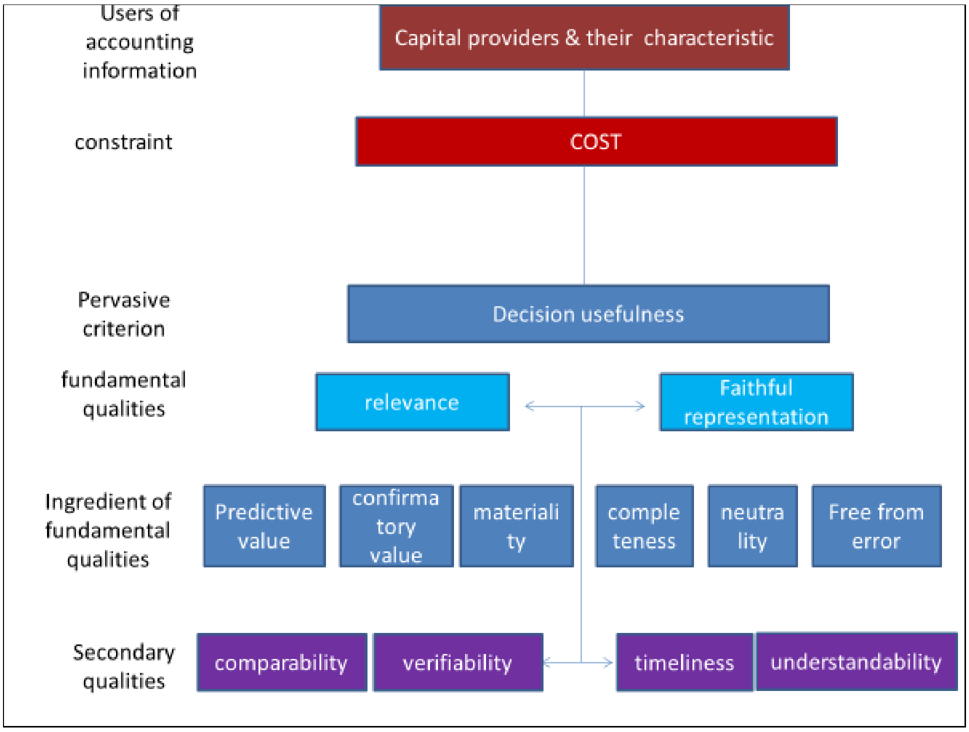
Second, as a result of soundly developed conceptual framework, the profession should be able to more quickly solve new and emerging practical problems by referring to an exsisting framework of basic theory

Conceptual framework



FIRST LEVEL: OBJECTIVES OF FINANCIAL REPORTING

- Useful to those making investment and credit decisions who have reasonable understanding of business and economic activities
- Helpful to present and potential investors & creditors in other user in assessing the amount, timing & uncertainty of future cash flows
- About economic resources, the claims to those resources, and the changes in them



SECOND LEVEL: Fundamental Concept

- Qualitative characteristic of accounting information
- Elements of financial statements

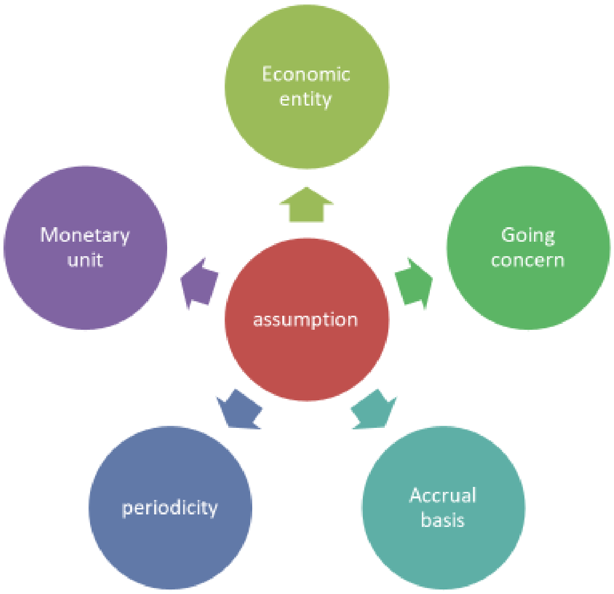
- Understandability is the quality of information that permits reasonably informed users to perceive its significance
- Relevant, to be relevant accounting information must be capable of making a difference in a decision. Relevant information helps users make predictions about the outcome of past, present and future value (predictive value), or correct prior expectations (confirmatory value)
- Verifiability is demonstrated when a high degree of consensus can be secured among independent measurers using the same measurement methods
- Representational faithfulness means agreement between the accounting numbers and descriptions and the resources or events that these numbers and descriptions purport to represent
- Comparability information that has been measured and reported in a similar manner for different enterprises is considered comparable

Elements of financial statement

- Assets
- Liabilities
- equity
- Income
- expenses

THIRD LEVEL:

- Assumption
- Principles
- constraints



Basic Principles

measurement	• Historical cost • Fair value
Revenue recognition	• Companies recognize revenue in the accounting period in which the performance obligation is satisfied
Expense recognition	• Product cost • Period cost
Full disclosure principle	• Sufficient detail to disclose matters that make a difference to users • Sufficient condensation to make the information understandable, keeping in mind costs of preparing and using it

The accounting information system

Dekeng Setyo B, Dr, Ak, CA

Learning objectives

- Understand basic accounting terminology
- Explain double-entry rules
- Identify steps in the accounting cycle
- Record transactions in journals, post to ledger accounts and prepare a trial balance
- Explain the reason for preparing adjusting entries
- Prepare financial statements from the adjusted trial balance
- Prepare closing entries

Preview of chapter 3

The accounting information system

Accounting information system

- Basic terminology
- Debits & credits
- Accounting equation
- Financial statement & ownership structure

The accounting cycle

- Identifying & recording
- Journalizing
- Posting
- Trial balance
- Adjusting entries
- Adjusted trial balance
- Preparing financial statement
- Closing
- Post closing trial balance
- Reversing entries
- summary

Financial statement for merchandisers

- Income statement
- Retained earning statement
- Statement of financial position
- Closing entries

- Event a happening of consequence to an entity, generally is the source or cause of change in assets, liabilities & equity
- Transaction an external event involving the transfer or exchange of something of value between two entities
- Account a systematic arrangement that shows the effect of transactions & other events on a specific assets or equity
- Real account real (permanent) account are assets, liability & equity
- Nominal account (temporary) account are revenue & expense (income statement)
- Ledger the book containing the account
- Journal the book of original entry where the essential fact & figures in connection with all transactions & selected other events are recorded initially
- Posting the mechanical process of transferring the essential fact & figures from the book of original entry to the account in the ledger
- Trial balance a list of all open account in the ledger & their balance
- Adjust entries made at the end of an accounting periods to bring all account up to date on an accrual accounting basis so that correct financial statement can be prepared
- Financial statement, statement that reflect the collection, tabulation, & final summarization of the accounting data

The accounting equation

- Owners invest $40.000 in exchange for ordinary share
- Disburse $600 cash for secretarial wages
- Purchase office equipment priced at $5.200, giving a 10% promissory note in exchange
- Receive $4.000 cash for service rendered
- Pay off a short-term liability of &7.000
- Declare a cash dividend of $5.000
- Convert a non current liability of $80.000 into ordinary share
- Pay cash of $16.000 for delivery van

Owners invest $40.000 in exchange for ordinary share

Assets	=	Liabilities	+	Equity
+40.000				+ 40.000

Disburse $600 cash for secretarial wages

Assets	=	Liabilities	+	Equity
-600				-600 (expenses)

Purchase office equipment priced at $5.200, giving a 10% promissory note in exchange

Assets	=	Liabilities	+	Equity
+5.200		+5.200		

Receive $4.000 cash for service rendered

Assets	=	Liabilities	+	Equity
+ 4.000				+4.000 (revenue)

Pay off a short-term liability of $ 7.000

Assets	=	Liabilities	+	Equity
-7.000		-7.000		

Declare a cash dividend of $5.000

Assets	=	Liabilities	+	Equity
		+5.000		- 5.000

Convert a non current liability of $80.000 into ordinary share

Assets	=	Liabilities	+	Equity
		- 80.000		+ 80.000

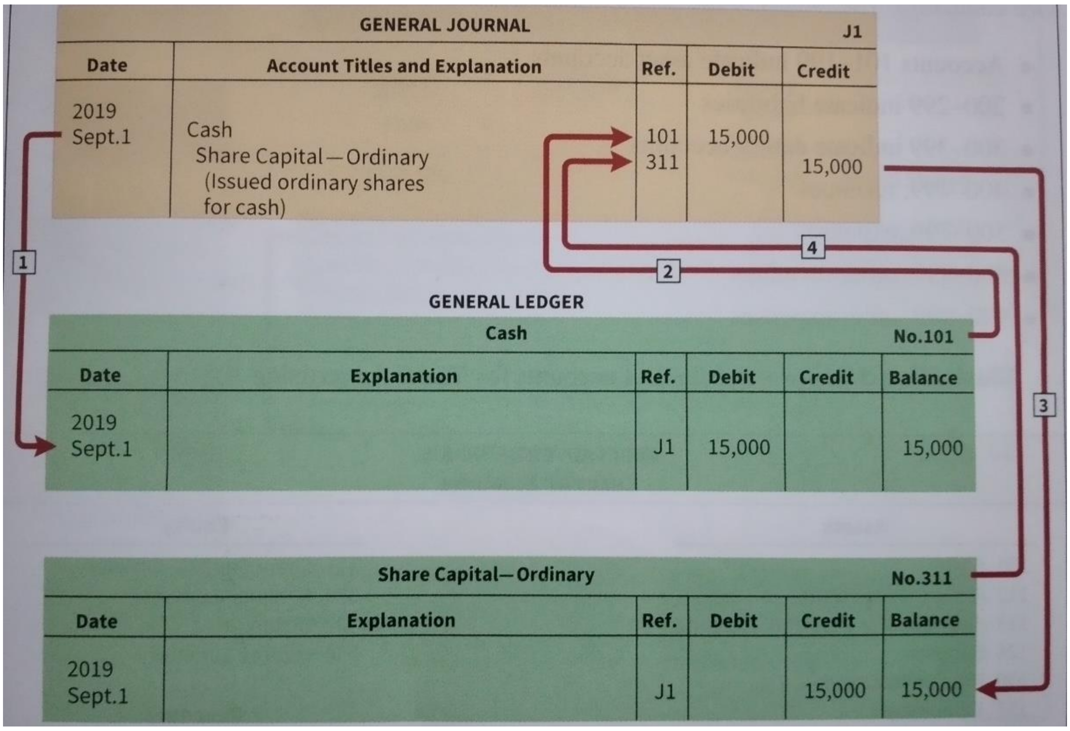
Pay cash of $16.000 for delivery van

Assets	=	Liabilities	+	Equity
- 16.000 (cash) + 16.000 (van)				

Journalizing & posting

- 1 September 2015, shareholder invested $15.000 cash in the corporation in exchange for ordinary share
- 1 September 2015, purchase computer equipment for $7000 cash
-

Date	Acc Titles	D	K
1 sep	Cash Share Capital (issued ordinary share)	15.000	15.000
	Equipment Cash (purchase equipment)	7.000	7.000



GENERAL JOURNAL — J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2019 Sept.1	Cash	101	15,000	
	Share Capital—Ordinary	311		15,000
	(Issued ordinary shares for cash)			

GENERAL LEDGER

Cash — No.101

Date	Explanation	Ref.	Debit	Credit	Balance
2019 Sept.1		J1	15,000		15,000

Share Capital—Ordinary — No.311

Date	Explanation	Ref.	Debit	Credit	Balance
2019 Sept.1		J1		15,000	15,000

Expanded example

- October 1, shareholder invest $100.000 cash in an advertising venture to be known as yazici advertising agency inc.
- October 1, Yazici advertising purchases office equipment costing $50.000 by sign-in a 3 month, 12%, $50.000 note payable
- October 2, Yazici advertising receives a $12.000 cash advance from Knox, a client, for advertising services that are expected to be completed by December 31.
- October 3, pays $9.000 office rent, in cash, for october
- October 4, pays $6.000 for one year insurance policy that will expire next year on September 30.

Transaction
On October 1, C. R. Yazici invests ₺100,000 cash in an advertising company to be known as Yazici Advertising A.Ş.

Basic Analysis
The asset Cash increases ₺100,000; equity (specifically, Share Capital—Ordinary) increases ₺100,000.

Equation Analysis

Assets	=	Liabilities	+	Equity	
Cash	=			Share Capital	
+100,000				+100,000	Issued Shares

Debit–Credit Analysis
Debits increase assets: debit Cash ₺100,000.
Credits increase equity: credit Share Capital—Ordinary ₺100,000.

Journal Entry

Oct. 1	Cash	101	100,000	
	Share Capital—Ordinary	311		100,000
	(Issued shares for cash)			

Posting

Cash	101
Oct. 1 100,000	

Share Capital—Ordinary	311
	Oct. 1 100,000

Transaction
On October 1, C. R. Yazici invests ₺100,000 cash in an advertising company to be known as Yazici Advertising A.Ş.

Basic Analysis
The asset Cash increases ₺100,000; equity (specifically, Share Capital—Ordinary) increases ₺100,000.

Equation Analysis

Assets	=	Liabilities	+	Equity	
Cash	=			Share Capital	
+100,000				+100,000	Issued Shares

Debit–Credit Analysis
Debits increase assets: debit Cash ₺100,000.
Credits increase equity: credit Share Capital—Ordinary ₺100,000.

Journal Entry

Oct. 1	Cash	101	100,000	
	Share Capital—Ordinary	311		100,000
	(Issued shares for cash)			

Posting

Cash	101
Oct. 1 100,000	

Share Capital—Ordinary	311
	Oct. 1 100,000

Transaction

On October 2, Yazici Advertising receives a ₺12,000 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 ₺12,000; the liability Unearned Service Revenue increases ₺12,000 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		
+12,000		+12,000		

Debit–Credit Analysis

Debits increase assets: debit Cash ₺12,000.
Credits increase liabilities: credit Unearned Service Revenue ₺12,000.

Journal Entry

Oct. 2	Cash	101	12,000	
	Unearned Service Revenue	209		12,000
	(Received cash from R. Knox for future service)			

Posting

Cash	101
Oct. 1 100,000 2 12,000	

Unearned Service Revenue	209
	Oct. 2 12,000

Transaction

On October 3, Yazici Advertising pays office rent for October in cash, ₺9,000.

Basic Analysis

Rent Expense increases ₺9,000 because the payment pertains only to the current month; the asset Cash decreases ₺9,000.

Equation Analysis

Assets	=	Liabilities	+	Equity	
Cash	=			Expenses	
−9,000				−9,000	Rent Expense

Debit–Credit Analysis

Debits increase expenses: debit Rent Expense ₺9,000.
Credits decrease assets: credit Cash ₺9,000.

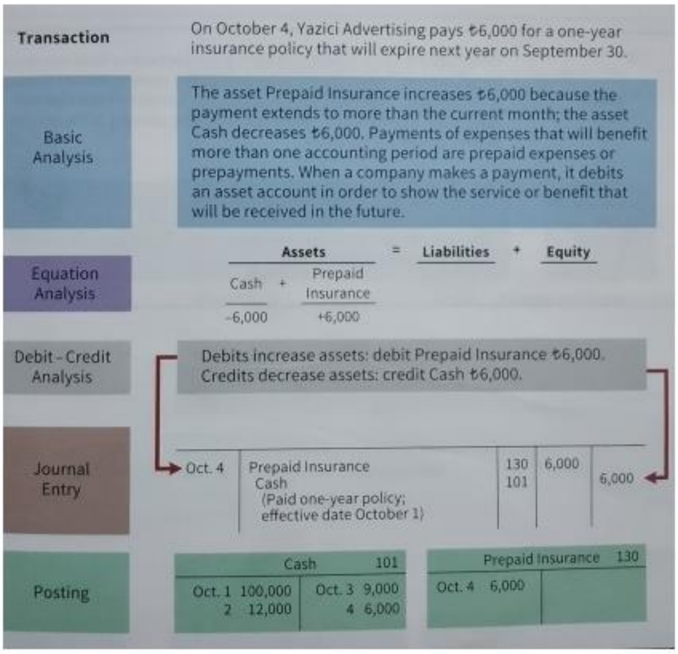
Journal Entry

Oct. 3	Rent Expense	729	9,000	
	Cash	101		9,000
	(Paid October rent)			

Posting

Cash	101
Oct. 1 100,000 2 12,000	Oct. 3 9,000

Rent Expense	729
Oct. 3 9,000	



Transaction
On October 4, Yazici Advertising pays ₺6,000 for a one-year insurance policy that will expire next year on September 30.

Basic Analysis
The asset Prepaid Insurance increases ₺6,000 because the payment extends to more than the current month; the asset Cash decreases ₺6,000. 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

Assets		= Liabilities	+ Equity
Cash +	Prepaid Insurance		
-6,000	+6,000		

Debit-Credit Analysis
Debits increase assets: debit Prepaid Insurance ₺6,000.
Credits decrease assets: credit Cash ₺6,000.

Journal Entry

Oct. 4	Prepaid Insurance	130	6,000	
	Cash	101		6,000
	(Paid one-year policy; effective date October 1)			

Posting

Cash		101
Oct. 1 100,000	Oct. 3 9,000	
2 12,000	4 6,000	

Prepaid Insurance		130
Oct. 4 6,000		

- October 5, purchases for $25.000 on account, an estimated 3-month supply of advertising material from Aero supply.
- October 20, board of directors declares and pays a $5.000 cash dividend to shareholder
- October 26, pays employee salaries in cash. Employee are paid once a month, every 4 weeks. In total payroll is $ 10.000/ weeks, or $2.000/ days. In October, the pay period began on Monday, 1 October. as a result, the pay period ended on Friday, October 26, with salaries of $40.000 being paid.
- October 31, receives $28.000 in cash & bills Copa Company $72.000 for advertising service of $100.000 provided in October.

Transaction

On October 5, Yazici Advertising purchases an estimated three-month supply of advertising materials on account from Aero Supply for ₺25,0

Basic Analysis

The asset Supplies increases ₺25,000; the liability Accounts Payable increases ₺25,000.

Equation Analysis

Assets	=	Liabilities	+	Equity
Supplies	=	Accounts Payable		
+25,000		+25,000		

Debit – Credit Analysis

Debits increase assets: debit Supplies ₺25,000.
Credits increase liabilities: credit Accounts Payable ₺₺25,000.

Journal Entry

Oct. 5	Supplies	126	25,000	
	Accounts Payable	201		25,000
	(Purchased supplies on account from Aero Supply)			

Posting

Supplies	126
Oct. 5 25,000	

Accounts Payable	201
	Oct. 5 25,000

Transaction

On October 20, Yazici Advertising's board of directors declares and pays a ₺5,000 cash dividend to shareholders.

Basic Analysis

The Dividends account increases ₺5,000; the asset Cash decreases ₺5,000.

Equation Analysis

Assets	=	Liabilities	+	Equity
Cash	=			Dividends
-5,000				-5,000

Debit-Credit Analysis

Debits increase dividends: debit Dividends ₺5,000.
Credits decrease assets: credit Cash ₺5,000.

Journal Entry

Oct. 20	Dividends	332	5,000	
	Cash	101		5,000
	(Declared and paid a cash dividend)			

Posting

Cash	101
Oct. 1 100,000	Oct. 3 9,000
2 12,000	4 6,000
	20 5,000

Dividends	332
Oct. 20 5,000	

Transaction

On October 26, Yazici Advertising pays employee salaries and wages in cash. Employees are paid once a month, every four weeks. The total payroll is ₺10,000 per week, or ₺2,000 per day. In October, the pay period began on Monday, October 1. As a result, the pay period ended on Friday, October 26, with salaries and wages of ₺40,000 being paid.

Basic Analysis

Salaries and Wages Expense increases ₺40,000; the asset Cash decreases ₺40,000.

Equation Analysis

Assets	=	Liabilities	+	Equity	
Cash	=			Expenses	
−40,000				−40,000	Salaries and Wages Expense

Debit–Credit Analysis

Debits increase expenses: debit Salaries and Wages Expense ₺40,000.
Credits decrease assets: credit Cash ₺40,000.

Journal Entry

Oct. 26	Salaries and Wages Expense	726	40,000	
	Cash	101		40,000
	(Paid salaries to date)			

Posting

Cash			101
Oct. 1	100,000	Oct. 3	9,000
2	12,000	4	6,000
		20	5,000
		26	40,000

Salaries and Wages Expense			726
Oct. 26	40,000		

Transaction

On October 31, Yazici Advertising receives ₺28,000 in cash and bills Copa Company ₺72,000 for advertising services of ₺100,000 performed in October.

Basic Analysis

The asset Cash increases ₺28,000; the asset Accounts Receivable increases ₺72,000; the revenue account Service Revenue increases ₺100,000.

Equation Analysis

Assets			=	Liabilities	+	Equity	
Cash	+	Accounts Receivable	=			Revenues	
+28,000		+72,000				+100,000	Service Revenue

Debit–Credit Analysis

Debits increase assets: debit Cash ₺28,000; Accounts Receivable ₺72,000. Credits increase revenues: credit Service Revenue ₺100,000.

Journal Entry

Oct. 31	Cash	101	28,000	
	Accounts Receivable	112	72,000	
	Service Revenue	400		100,000
	(Recognize revenue for services performed)			

Posting

Cash			101
Oct. 1	100,000	Oct. 3	9,000
2	12,000	4	6,000
31	28,000	20	5,000
		26	40,000

Accounts Receivable			112
Oct. 31	72,000		

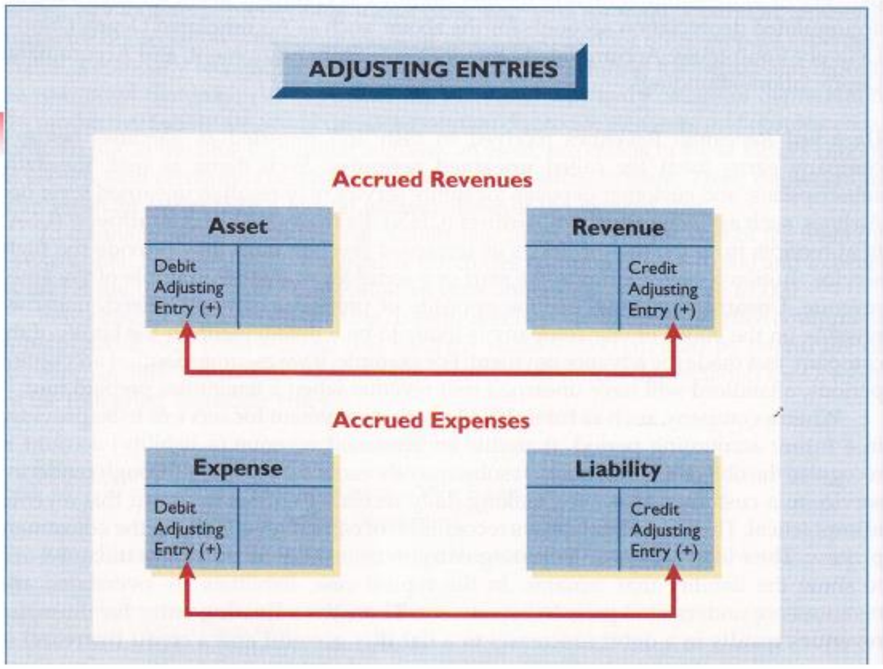
Service Revenue			400
		Oct. 31	100,000

	Debit	Credit
Cash	$ 80,000	
Accounts Receivable	72,000	
Advertising Supplies	25,000	
Prepaid Insurance	6,000	
Office Equipment	50,000	
Notes Payable		$ 50,000
Accounts Payable		25,000
Unearned Service Revenue		12,000
Share Capital—Ordinary		100,000
Dividends	5,000	
Service Revenue		100,000
Salaries Expense	40,000	
Rent Expense	9,000	
	$287,000	$287,000

Adjusting entries

Adjusting entries are therefore necessary to achieve a proper matching of revenue & expenses in the determination of net income for the current period & to achieve an accurate statement of the assets & equities existing at the end of periods. Normally the adjustments are classified in the following manner:

deferrals	**Accruals**
Prepaid expenses, expenses paid in cash & recorded as assets before they used or consumer	Accrued revenues, revenues earned but not yet received in cash or recorded
Unearned revenues, revenues received in cash & recorded as liabilities before they are earned	Accrued expenses, expenses incurred but not yet paid in cash or recorded

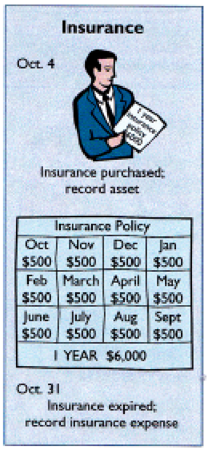


Prepaid expenses

- Yazici Adv. purchased advertising supplies costing $25.000, 5 Okt. An inventory count at the close of business 31 okt reveals that $ 10.000 of supplies on hand. Yazici makes the following adjusting entry

- Without an adjusting entry, okt expenses are understated and net income overstated by $ 15.000. more over both assets and equity are overstated by $ 15.000 on okt 31 financial position

- paid $ 6.000 for a one year fire insurence policy beginning 4 okt. An analysis of the policy reveals that $500 ($6.000: 12) of insurance expires each month.
- Without an adjusting entry, okt expenses are understanted $500 and net income overstated by $ 500. more over both assets and equity are overstated by $ 500 on okt 31 financial position



- Yazici adv. estimates depreciation on its office equipment to be $ 4.800 a year (cost $50.000 less residual value $2.000, divided by useful life of 10 years) or $ 400 per month
- Office equipment is a contra asset account. This means that the accumulated depreciation account offsets the office equipment account on the financial statement position

Unearned revenue

- Yazici adv. received $12.000 on oct 2 from R. Knox for advertising services expected to be completed by December 31. analysis reveals that pioneer earned $4.000 of these service in oct.

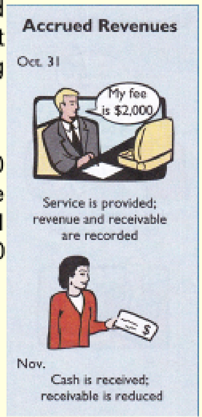
- Without an adjusting entry, revenue and net income understated by $ 4.000 in the income statement. more over liabilities are overstated by $ 4.000 on okt 31 financial position

Accrued revenues

- In oct.yazici earned $2.000 for adv. services that it did not bill to clients before oct 31. Yacizi did not yet record these service, thusYazici makes the following adjusting entry:

- The account receivable show that clients owe $ 74.000 at the statement of financial position date. The balance $ 106.000 in service revenue represents the total revenue earned during the month ($100.000 + $ 4.000 + $ 2.000)

- Without an adjusting entry, assets, equity on the statement financial position, and revenue and net income on the income statement are understated



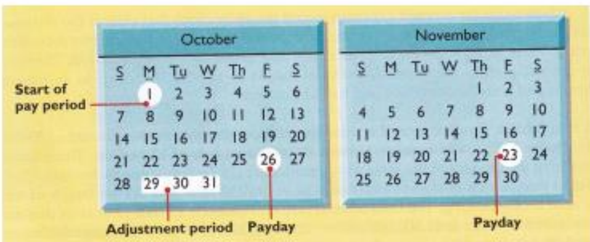
ACCRUED EXPENSES

Yazici signed a three month note payable in the amount $50.000 on oct 12 % total interest due on Yazici note at its due date hance is ($ 50.000 x 12 % x 3/12) $1.500 or $ 500 for one month

Face Value of Note	×	Annual Interest Rate	×	Time in Terms of One Year	=	Interest
$50,000	×	12%	×	1/12	=	$500

ACCRUED SALARIES

- Pioneer last paid salaries on oct 26. it will not pay salaries until nov 23, at oct 31, the employees received total salaries of $ 10.000 for 5 day work at week, the adjusting entry as follows:
- *After this adjustment, the balance in salaries expense of $46.000 (23*2.000) is the actual salary expense for oct. the balance salaries payable of $6.000 is the amount of the liability for salaries owed as of oct 31. without this adjustment, pioneer expenses & liability are understated by $6.000*



26	**Salaries expense**	**40.000**	
	Cash		40.000
31	Salaries expense	6.000	
	salaries payable		6.000
23	Salaries expense	34.000	
	Salaries payable	6.000	
	cash		40.000

Bad debt

- at the end of period, a company estimate the amount of receivables that will later prove to be uncollectible. The estimate on various factor: the amount bed debts in experienced in past year, general economic condition,
- To illustrate assume that based on past experience, pioneer estimate a bed debt expense for month of $1.600, it make the adjusting entry for bad debt as follows:

Adjusted Trial Balance
October 31, 2011

Account	Debit	Credit
Cash	$80,000	
Accounts Receivable	74,000	
Allowance for Doubtful Accounts		$ 1,600
Advertising Supplies	10,000	
Prepaid Insurance	5,500	
Office Equipment	50,000	
Accumulated Depreciation—Office Equipment		400
Notes Payable		50,000
Accounts Payable		25,000
Unearned Service Revenue		8,000
Salaries Payable		6,000
Interest Payable		500
Share Capital—Ordinary		100,000
Retained Earnings		-0-
Dividends	5,000	
Service Revenue		106,000
Salaries Expense	46,000	
Advertising Supplies Expense	15,000	
Rent Expense	9,000	
Insurance Expense	500	
Interest Expense	500	
Depreciation Expense	400	
Bad Debt Expense	1,600	
	$297,500	$297,500

Income Statement
For the Month Ended October 31, 2011

Revenues		
Service Revenue		$106,000
Expenses		
Salaries expense	$46,000	
Advertising supplies expense	15,000	
Rent expense	9,000	
Insurance expense	500	
Interest expense	500	
Depreciation expense	400	
Bad debt expense	1,600	
Total expenses		73,000
Net income		$ 33,000

Retained Earnings Statement
For the Month Ended October 31, 2011

Retained earnings, October 1	$ -0-
Add: Net income	33,000
	33,000
Less: Dividends	5,000
Retained earnings, October 31	$28,000

To the statement of financial position

Adjusted Trial Balance
October 31, 2011

Account	Debit	Credit
Cash	$80,000	
Accounts Receivable	74,000	
Allowance for Doubtful Accounts		$ 1,600
Advertising Supplies	10,000	
Prepaid Insurance	5,500	
Office Equipment	50,000	
Accumulated Depreciation—Office Equipment		400
Notes Payable		50,000
Accounts Payable		25,000
Unearned Service Revenue		8,000
Salaries Payable		6,000
Interest Payable		500
Share Capital—Ordinary		100,000
Retained Earnings		-0-
Dividends	5,000	
Service Revenue		106,000
Salaries Expense	46,000	
Advertising Supplies Expense	15,000	
Rent Expense	9,000	
Insurance Expense	500	
Interest Expense	500	
Depreciation Expense	400	
Bad Debt Expense	1,600	
	$297,500	$297,500

Statement of Financial Position
October 31, 2011

Assets		
Office equipment	$50,000	
Less: Accumulated depreciation	400	$49,600
Advertising supplies		10,000
Prepaid insurance		5,500
Accounts receivable	74,000	
Less: Allowance	1,600	72,400
Cash		80,000
Total assets		$217,500
Equity and Liabilities		
Equity		
Share capital—ordinary	$100,000	
Retained earnings	28,000	
Total equity		$128,000
Liabilities		
Notes payable	50,000	
Accounts payable	25,000	
Unearned service revenue	8,000	
Salaries payable	6,000	
Interest payable	500	
Total liabilities		89,500
Total equity and liabilities		$217,500

Balance at Oct. 31 from retained earnings statement in Illustration 3-34

INCOME STATEMENT & RELATED INFORMATION

Learning objective

- Understand the uses and limitation of an income statement
- Understand the content and format of the income statement
- Prepare an income statement
- Explain how to report items in the income statement
- Identify where to report earnings per share information
- Explain intra-period tax allocation
- Understand the reporting of accounting changes and errors

Preview of chapter 4

Income statement & related information

Income statement

- Usefulness
- Limitation
- Quality of earning

Format income statement

- Elements
- Minimum disclosure
- Intermediate components
- Illustration
- Condensed income statement

Reporting within income statement

- Gross profit
- Income from operations
- Income before income tax
- Net income
- Non-controlling interest
- Earning per share
- Discontinued operation
- Intra-period tax allocation
- summary

Other reporting issues

- Accounting changes and errors
- Retained earning statement
- Comprehensive income
- Statement of changes in equity

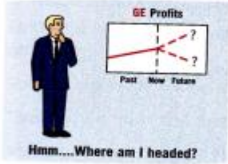
Income statement

- The income statement is the report that measures the success of company operations for given period of time.
- It provides investors and creditors with information that helps them predict the amounts, timing, and uncertainty of future cash flows

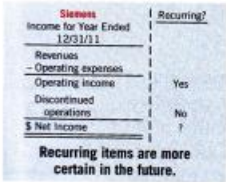
Usefulness of the income statement

Evaluate the past performance of the company

Provide a basis for predicting future performance



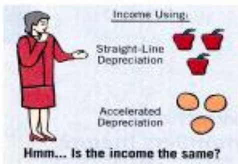
Help assess the risk or uncertainty of achieving future cash flows



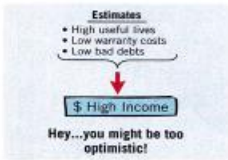
Limitation of the income statement

Companies omit items from the income statement that they cannot measure reliably

Income numbers are affected by the accounting methods employed



Income measurement involves judgment



Quality of earnings

The information of the income statement for credit decisions, including the evaluation of the company and it managers

Companies try to meet or beat market expectations so that the market price of their shares & the value of management compensation increase. As a result, companies have incentives to manage income to meet earnings target or to make earnings look less risky

Regulators have expressed concern that the motivations to meet earnings target may override good business practices. This erodes the quality of earnings and the quality of financial reporting.

ELEMENTS OF FINANCIAL STATEMENTS

INCOME. Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from shareholders.

EXPENSES. Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to shareholders. [1]

1. **Sales or Revenue Section.** Presents sales, discounts, allowances, returns, and other related information. Its purpose is to arrive at the net amount of sales revenue.
2. **Cost of Goods Sold Section.** Shows the cost of goods sold to produce the sales.

Gross Profit. Revenue less cost of goods sold.

3. **Selling Expenses.** Reports expenses resulting from the company's efforts to make sales.
4. **Administrative or General Expenses.** Reports expenses of general administration.
5. **Other Income and Expense.** Includes most other transactions that do not fit into the revenues and expenses categories provided above. Items such as gains and losses on sales of long-lived assets, impairments of assets, and restructuring charges are reported in this section. In addition, revenues such as rent revenue, dividend revenue, and interest revenue are often reported.

Income from Operations. Company's results from normal operations.

6. **Financing Costs.** A separate item that identifies the financing cost of the company, hereafter referred to as *interest expense*.

Income before Income Tax. The total income before income tax.

7. **Income Tax.** A short section reporting taxes levied on income before income tax.

Income from Continuing Operations. A company's results before any gain or loss on discontinued operations. If the company does not have any gain or loss on discontinued operations, this section is not reported and this amount is reported as net income.

8. **Discontinued Operations.** Gains or losses resulting from the disposition of a component of a company.

Net Income. The net results of the company's performance over a period of time.

9. **Non-Controlling Interest.** Presents an allocation of net income to the primary shareholders and to the non-controlling interest (also referred to as *minority interest*).
10. **Earnings per Share.** Per share amounts that are reported.

BOC HONG COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2011

Sales revenue			
Sales			$3,053,081
Less: Sales discounts		$ 24,241	
Sales returns and allowances		56,427	80,668
Net sales revenue			2,972,413
Cost of goods sold			1,982,541
Gross profit			989,872
Selling expenses			
Sales salaries and commissions	$202,644		
Sales office salaries	59,200		
Travel and entertainment	48,940		
Advertising expense	38,315		
Freight and transportation-out	41,209		
Shipping supplies and expense	24,712		
Postage and stationery	16,788		
Telephone and Internet expense	12,215		
Depreciation of sales equipment	9,005	453,028	
Administrative expenses			
Officers' salaries	186,000		
Office salaries	61,200		
Legal and professional services	23,721		
Utilities expense	23,275		
Insurance expense	17,029		
Depreciation of building	18,059		
Depreciation of office equipment	16,000		
Stationery, supplies, and postage	2,875		
Miscellaneous office expenses	2,612	350,771	803,799
Other income and expense			
Dividend revenue		98,500	
Rental revenue		42,910	
Gain on sale of plant assets		30,000	171,410
Income from operations			357,483
Interest on bonds and notes			126,060
Income before income tax			231,423
Income tax			66,934
Net income for the year			$ 164,489
Attributable to:			
Shareholders of Boc Hong			$ 120,000
Non-controlling interest			44,489
Earnings per share			$1.74

Statement of financial position & statement of cash flows

Learning Objectives

- After studying this chapter you should be able to:
- Explain the uses and limitations of a statement of financial position
- Identify the major classifications of the statement of financial position
- Prepare a classified statement of financial position using the report and account format
- Indicate the purpose of the statement of cash flows
- Identify the content of the statement of cash flows
- Prepare a basic statement of cash flows

STATEMENT OF FINANCIAL POSITION

BUSINESS		
Operating		
Inventories	€ 400,000	
Receivables	200,000	
Total short-term assets		€ 600,000
Property (net)	500,000	
Intangible assets	50,000	
Total long-term assets		550,000
Accounts payable	30,000	
Wages payable	40,000	
Total short-term liabilities		(70,000)
Lease liability	10,000	
Other long-term debt	35,000	
Total long-term liabilities		(45,000)
Net operating assets		**1,035,000**
Investing		
Trading securities	45,000	
Other securities	5,000	
Total investing assets		50,000
TOTAL NET BUSINESS ASSETS		**1,085,000**
FINANCING		
Financing assets		
Cash	30,000	
Total financing assets		30,000
Financing liabilities		
Short- and long-term borrowing	130,000	
Total financing liabilities		130,000
NET FINANCING LIABILITIES		**100,000**
DISCONTINUED OPERATIONS		
Assets held for sale		420,000
INCOME TAXES		
Deferred income taxes		70,000
NET ASSETS		**€1,475,000**
EQUITY		
Share capital—ordinary	€1,000,000	
Retained earnings	475,000	
TOTAL EQUITY		**€1,475,000**

Preview of chapter 5

Statement of financial position & statement of cash flows

Statement of financial position

- Usefulness
- Limitation
- Qualification

Statement of cash flows

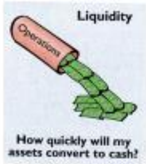
- Purpose
- Content and format
- Preparation overview
- usefulness

Additional information

- Notes
- Techniques of disclosure
- Other guidelines

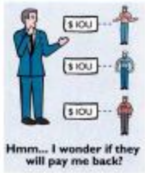
Usefulness of financial position

Liquidity, describe the amount of time that is expected to elapse until an asset is realized or otherwise converted into cash or until liability has to be paid



Solvency, refers to ability of a company to pay its debts as they mature

Liquidity & solvency affect a companies financial flexibility, which measures the ability of an enterprise to take effective action to alter the amount and timing of cash flows so it can respond to unexpected needs & opportunities

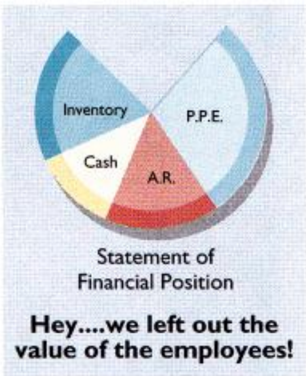


Limitation of the statement of financial position

Most asset & liabilities are reported at historical cost, for example PAMEX own crude oil & gas, that may appreciate in value. Yet, it reports any increase only if and when it sells the assets

Companies use judgment & estimate to determine many of items reported in the statement of financial position. Lenovo estimates the amount of receivables that it will collect & the number of computer that will be returned under warranty

Necessarily omits many items that are of financial value but that company cannot record objectively. The knowledge & skill of INTEL employees in developing new computer chip are arguably the companies most significant assets



Classification

- Assets & liabilities with **different general liquidity characteristic**, for example Nokia report cash separately from inventories
- Assets that differ in their **expected function** in the companies central operations or other activities. For example IBM report merchandise inventories separately from property, plant & equipment
- Liabilities that differ in their **amount, nature & timing**. For example royal ahold should report account payable separately from its pension liability

ELEMENTS OF THE STATEMENT OF FINANCIAL POSITION

1 **ASSET.** Resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

2 **LIABILITY.** Present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

3 **EQUITY.** Residual interest in the assets of the entity after deducting all its liabilities.

EQUITY SECTION

1 **SHARE CAPITAL.** The par or stated value of shares issued. It includes ordinary shares (sometimes referred to as *common shares*) and preference shares (sometimes referred to as *preferred shares*).

2 **SHARE PREMIUM.** The excess of amounts paid-in over the par or stated value.

3 **RETAINED EARNINGS.** The corporation's undistributed earnings.

4 **ACCUMULATED OTHER COMPREHENSIVE INCOME.** The aggregate amount of the other comprehensive income items.

5 **TREASURY SHARES.** Generally, the amount of ordinary shares repurchased.

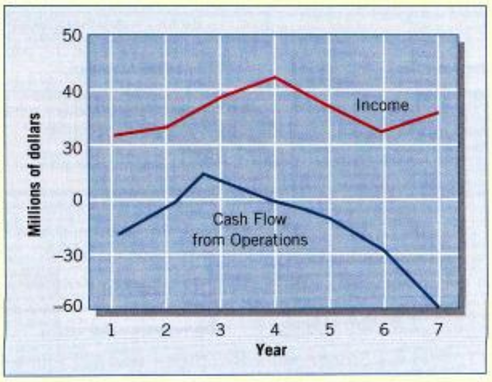
6 **NON-CONTROLLING INTEREST (MINORITY INTEREST).** A portion of the equity of subsidiaries not owned by the reporting company.

Purpose of the statement of cash flows

- The primary purpose of the statement of cash flows is to provide relevant information about the cash receipts & cash payments of an enterprise during a period. To achieve this purpose, the statement of cash flows report the following:
  - The cash effect of operation during the period
  - Investing transaction
  - Financing transaction
  - The net increase or decrease in cash during the period

WATCH THAT CASH FLOW

Investors usually focus on net income measured on an accrual basis. However, information on cash flows can be important for assessing a company's liquidity, financial flexibility, and overall financial performance. The graph below shows **W. T. Grant**'s (USA) financial performance over 7 years.



Although W. T. Grant showed consistent profits and even some periods of earnings growth, its cash flow began to "go south" starting in about year 3. The company filed for bankruptcy shortly after year 7. Financial statement readers who studied the company's cash flows would have found early warnings of W. T. Grant's problems. The Grant experience is a classic case, illustrating the importance of cash flows as an early-warning signal of financial problems.

A more recent retailer case is **Target** (USA). Although Target has shown good profits, some are concerned that a bit too much of its sales have been made on credit rather than cash. Why is this a problem? Like W. T. Grant, the earnings of profitable lenders can get battered in future periods if they have to start adding large amounts to their bad-loan reserve to catch up with credit losses. And if losses ramp up on Target-branded credit cards, Target may get hit in this way.

Source: Peter Eavis, "Is Target Corp.'s Credit Too Generous?" *Wall Street Journal* (March 11, 2008), p. C1.

Content & format

- Companies classify cash receipts and cash payment during a period into tree different activities in the statement of cash flows, defined as follows:
  - Operating activities involve the cash effects of transactions that enter into the determination of net income
  - Investing activities include making & collecting loans & acquiring & disposing of investment (both debt & equity) and property plant & equipment
  - Financing activities involve liability & equity items. They include (a) obtaining resources from owners & providing them with a return on their investment (b) borrowing money from creditors & repaying the amounts borrowed

TELEMARKETING						
THE STATEMENT OF FINANCIAL POSITION						Why??
		2018	2019			
Assets						
Cash		31,000	62,000	increase	31,000	
Account Receivable		41,000	82,000	increase	41,000	OA
Land		15,000	30,000	increase	15,000	IA
	TOTAL	87,000	174,000			
Liability & Equity						
Account Payable		12,000	24,000	increase	12,000	OA
Share Capital		50,000	100,000	increase	50,000	FA
~~Retained Earning~~		~~25,000~~	~~50,000~~	~~increase~~	~~25,000~~	
	TOTAL	87,000	174,000			

TELEMARKETING	
INCOME STATEMENT	
Revenue	172,000
Operating Expense	(120,000)
Income before tax	52,000
Income TAX	(13,000)
Net Income	39,000
Devidens of 14.000 were paid during the year	

Retained earning 18:	25.000
Net Income :	39.000
	64.000
Devidend :	-14.000
Retained earning 19:	50.000

- The company determines its investing and financing activities. Telemarketing only investing activity was land purchase. It had two financing activities:
  - Share capital ordinary increased $50.000 from the issuance of ordinary shares for cash
  - The company paid $14.000 cash in dividends.

TELEMARKETING STATEMENT OF CASH FLOWS		
Net Income		39.000
Cashflows from OA increase in accounts receivable increase in accounts payable	 (41.000) 12.000	 (29.000)
Net cash provided by OA		10.000
Cash flows from IA increase in land	 (15.000)	
Net cash used by IA		(15.000)
Cash flows from FA issuance of ordinary share payment of cash devidend	 50.000 (14.000)	
Net cash provided by FA		36.000
Net increase in cash		31.000
Cash at 2018		31.000
Cash at 2019		62.000

Usefulness of cash flows

Financial liquidity. Readers of financial statement often asses liquidity by using the current cash debt coverage ratio. It indicates whether the company can pay off its current liabilities from its operation in a given year

$$\frac{\textit{net cash provided by operating activities}}{\textit{average current liabilities}}$$

Financial flexibility. The cash debt coverage ratio provides information on financial flexibility. It indicates a companies ability to repay its liabilities from net cash provided by operating activities

$$\frac{\textit{net cash provided by operating activities}}{\textit{average total liabilities}}$$

Free cash flows. A more sophisticated way to examine a companies financial flexibility is to develop a free cash flows analysis. Free cash flows is the amount of discretionary cash flow from a company has.

Net cash provided by operating activities- capital expenditure- dividends

Accounting and the time value of money

Learning objectives

- After studying this chapter you should be able to:
  - Identify accounting topics where the time value of money is relevant
  - Distinguish between simple and compound interest
  - Use appropriate compound interest table
  - Identify variables fundamental to solving interest problems
  - Solve future and present value of 1 problems
  - Solve future value of ordinary and annuity due problems

Preview of chapter 6

Accounting and the time value of money

- **Basic time value concept**
  - Applications
  - The nature of interest
  - Simple interest
  - Compound interest
  - Fundamental variable
- **Single-sum problems**
  - FV single sum
  - PV single sum
  - Solving for other unknowns
- **Annuities**
  - FV of ordinary annuity
  - FV of annuity due
  - Examples of FV of annuity
  - PV of ordinary annuity
  - PV of annuity due
  - Examples of ordinary of annuity
- **More complex situation**
  - Deferred annuities
  - Valuation of long-term bond
  - Effective-interest method of bond discount/ premium amortization

Basic time value concept

- In accounting & finance, the phase time value of money indicates a relationship between time and money (that dollar received today is worth more than a dollar promised at some time in the future)
- Financial reporting uses different measurement in different situation (historical cost for equipment, net realizable value for inventories, fair value for investment)
- As discussed in the fair value guidance, PV techniques are used to convert expected cash flows into PV, which represent an estimate of fair value
- IFRS addresses PV as a measurement basis for a broad array of transaction, such as [1] account and loans receivable [2] leases [3] postretirement benefits [4] asset impairment [5] and share-based compensation

PRESENT VALUE-BASED ACCOUNTING MEASUREMENTS

1 **NOTES.** Valuing long-term receivables and payables that carry no stated interest rate or a lower than market interest rate.

2 **LEASES.** Valuing assets and obligations to be capitalized under long-term leases and measuring the amount of the lease payments and annual leasehold amortization.

3 **PENSIONS AND OTHER POSTRETIREMENT BENEFITS.** Measuring service cost components of employers' postretirement benefits expense and postretirement benefits obligation.

4 **LONG-TERM ASSETS.** Evaluating alternative long-term investments by discounting future cash flows. Determining the value of assets acquired under deferred payment contracts. Measuring impairments of assets.

5 **SHARE-BASED COMPENSATION.** Determining the fair value of employee services in compensatory share-option plans.

6 **BUSINESS COMBINATIONS.** Determining the value of receivables, payables, liabilities, accruals, and commitments acquired or assumed in a "purchase."

7 **DISCLOSURES.** Measuring the value of future cash flows from oil and gas reserves for disclosure in supplementary information.

8 **ENVIRONMENTAL LIABILITIES.** Determining the fair value of future obligations for asset retirements.

Simple & Compound

- Simple interest
- To illustrate, Keynes electric. Borrows $1.000 for 3 years with a simple interest rate of 8% per year. Computes the total interest it will pay as follows:
- Compound interest
- Vasquez Company deposits $10.000 in the last national bank, where it will earn simple interest of 9% per year. It deposits another $10.000 in the firs state bank, where it will earn compound interest of 9% per year.

Last National Bank

Simple Interest Calculation	Simple Interest	Accumulated Year-End Balance
Year 1 $10,000.00 × 9%	$ 900.00	$10,900.00
Year 2 $10,000.00 × 9%	900.00	$11,800.00
Year 3 $10,000.00 × 9%	900.00	$12,700.00
	$2,700.00	

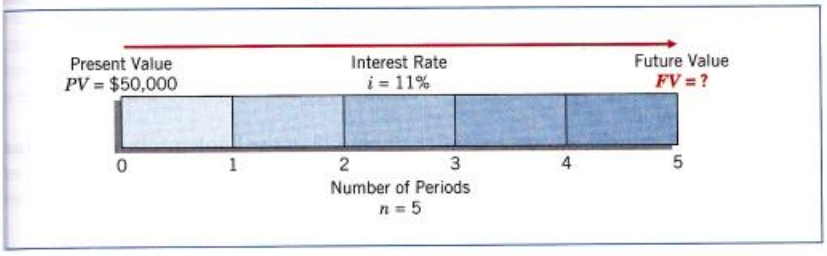
$250.29 Difference

First State Bank

Compound Interest Calculation	Compound Interest	Accumulated Year-End Balance
Year 1 $10,000.00 × 9%	$ 900.00	$10,900.00
Year 2 $10,900.00 × 9%	981.00	$11,881.00
Year 3 $11,881.00 × 9%	1,069.29	$12,950.29
	$2,950.29	

Future value of single sum

To illustrate, Bruegger Co. wants to determine the future value of $50,000 invested for 5 years compounded annually at an interest rate of 11%. Illustration 6-7 shows this investment situation in time-diagram form.



Solving for other unknowns in single sum problems

- Village of sommonauk wants to accumulate $ 70.000 for the construction in the town square, at the beginning of the current year deposited $47.811 in a memorial fund that earn 10 % interest compounded annually, how many years will it take to accumulate $ 70.000, in the memorial fund:

FV	=	PV(FVFn,10%)
70.000	=	47.811(FVFn,10%)
FVFn,10%	=	70.000 / 47.811
	=	1.46410

  using the future value factor of 1.46410, refer to table and read down the 10 % column to find that factor in the $ period row, thus, it will take 4 years for the $47.811 to acumulate to $70.000.

$ 124.000?

$ 85.000?

FUTURE VALUE ANNUITY

For example assume that $ 1 is deposited at the end of each of 5 years (an ordinary annuity) and earns 12 % interest compounded annually:

END OF PERIOD IN WHICH $1.00 IS TO BE INVESTED

Present	1	2	3	4	5	Value at End of Year 5
	$1.00					$1.57352
		$1.00				1.40493
			$1.00			1.25440
				$1.00		1.12000
					$1.00	1.00000
Total (future value of an ordinary annuity of $1.00 for 5 periods at 12%)						$6.35285

FVA = R (FVF – OAn,i)

To ilustrate what is the future value of five $ 5.000 deposits made at the end of each of the next 5 years, earning interest of 12 %

NILAI FVA = R (FVF – OAn,i)

= 5.000 (6.35285)

= 31.764,25

PRESENT VALUE ANNUITY

One approach to finding the present value of an annuity determines the present value of each of rents in the series and than totals their individual present value, for example we may view an annuity of $ 1 to be received at the end of each of 5 periods, as separate amounts, assuming an interest rate of 12 %

End of period in which 1,00 is o be received

PV at Beg year	1	2	3	4	5
0.89286	1.00				
0.79719		1.00			
0.71178			1.00		
0.63552				1.00	
0.56743					1.00
3.60478 (table)					

To illustrate with an example, what is the present value of rental receipts of $ 6.000 each, to be received at the end of each of the next 5 years when discounted at 12 %?

PVA = R (PVF – OA n,i)
= 6.000 (PVF – OA n,i)
= 6.000 (3.60478)
= 21.628,68

Computation of the interest rate

Many shoppers use credit cards to make purchase. For example assume you recieve a statement from master card with a balance due of $ 528.77 you may pay it off in 12 equal monthly payment of $50,00 each, what rate of interest would you be paying?

PVA = R (PVF – OA n,i)
528.77 = 50 (PVF – OA n,i)
PVF – OA n,i = 528.77 / 50
= 10.57540

Refering to the table and reading across the 12 period row, you find 10.57534 in the 2 % column, since 2 % is a monthly rate, the nominal annual rate of interest is 24 % (12 x 2%).

Valuation of long term bond

A long term bond produces two cash flow :

- Periodic interest payments during the life of the bond
- The principal (face value) paid at maturity

To illustrate IBM corporation on january 1, 2011, issues $100.000 of 9 % bonds due in 5 year with interest payable annually at year end, the current market rate of interest for bonds of similar risk is 11 %, what will the buyers pay for this bonds issue ?

IBM the present value of the two cash flows by discounting at 11 % as follows;

Present Value of the principal FV (PVF 5,11%)	= 100.000 (0.59345)	= 59.345
Present Value of interest (PVF-OA5,11%)	= 9.000 (3.69590)	= 33.263
Combined present value		= 92.608

Effective-interest method of amortization of bond discount/premium

Maturity value of bonds		100.000
Present Value of the principal	59.345	
Present Value of the interest	33.263	
Present value & cash received		92.608
Discount on bonds issues		7.391

We can use the data from IBM to illustrate the effective interest method of amortization. IBM issued $100,000 face value of bonds at a discount of $7.391 resulting in carrying value $92.608;

Schedule of bond discount amortization

date	Cash interest paid	Interest expense	Bond discount amortization	Carrying value of bonds
1/1/01				92.608,10
31/12/01	9.000[a]	10.186,89[b]	1.186,89[c]	93.794,99[d]
31/12/02	9.000	10.317,45	1.317,45	95.112,44
31/12/03	9.000	10.462,37	1.462,37	96.574,81
31/12/04	9.000	10.623,23	1.623,23	98.198,04
31/12/05	9.000	10.801,96	1.801,96	100.000
	45.000	52.391,90	7.391,90	

[a] 100.000 x 0.09 = 9.000
[b] 92.608,10 x 0.11 = 10.168,89
[c] 10.186,89 – 9.000 = 1.186,89
[d] 92.608,10 + 1.186 = 93.794

		D	K
1	CASH	92.608	
	Discount	7.392	
	BOND Payable		100.000
2	Interest expense (adjusting enteries)	10.186	
	interest payable		9.000
	Discount Amortization		1.186

Cash and receivable

Chapter 7

Learning objectives

- After studying this chapter, you should be able to:
  - Identify item considered cash
  - Indicate how to report cash and related items
  - Define receivables and identify the different types of receivables
  - Explain accounting issues related to recognition of account receivables
  - Explain accounting issues related to valuation of account receivables
  - Explain accounting issues related to recognition of note receivables
  - Explain accounting issues related to valuation of note receivables
  - Understand special topics related to receivables
  - Describe how to report and analyze receivables

Preview of chapter 7

Cash and receivables

- **cash**
  - What is cash
  - Reporting cash
  - Summary of cash-related items
- **Account receivables**
  - Recognition
  - Valuation
  - Impairment evaluation process
- **Notes receivable**
  - Recognition
  - valuation
- **Special issues**
  - Fair value option
  - De-recognition of receivables
  - Presentation and analysis

- Cash the most liquid of assets, is the standard medium of exchange & the basis for measuring and accounting for all other items. Negotiable instrument such as money order, certified check, cashiers check, personal check & bank draft also viewed as cash.

Account Receivable

Receivable are also financial assets, they are also a financial instrument. Receivable are claims held against customers & others for money, goods, or services

Recognition of accounts receivable

Gross method	Net method
Sales of $10.000 terms 2/10, n 30	
Acount receivable 10.000 sales 10.000	Account receivable 9.800 sales 9.800
Payment on $4.000 of sales received within discount period	
Cash 3.920 Sales discount 80 account receivable 4.000	Cash 3.920 account receivable 3.920
Payment on $6.000 of sales received after discount period	
Cash 6.000 account receivable 6.000	Account receivable 120 Sales disc forfeited 120 Cash 6.000 account receivable 6.000

RECOGNITION OF NOTES RECEIVABLE

- Note issued at face value
- To illustrate the discounting of note issued at face value, assume that bigelow corp, import $10.000 in exchange for $10.000, three year note receivable bearing interest at 10% annually

Face value of the note	10.000
Present value of principal	
$10.000 (PVF,3,10) = 10.000 x 0,751 = 7.513	
Present value of interest	
$1.000 (PVFoA,3,10) = 1.000 x 2,48 = 2.487	
Present value of note	10.000
Difference	-0-

Notes receivable	10.000	
cash		10.000

Interest receivable	1.000	
Interest revenue		1.000

NOTE NOT ISSUED AT FACE VALUE

- To illustrate, morgan co, make a loan to marie co, and receives in exchange three year $10.000 note bearing interest at 10% annualy, the market rate of interest for note of similar risk is 12%

Face value of the note	10.000
Present value of principal	
$10.000 (PVF,3,12) = 10.000 x 0,711 = 7.118	
Present value of interest	
$1.000 (PVFoA,3,12) = 1.000 x 2,401 = 2.402	
Present value of note	9.520
Difference (discount)	480

Notes receivables	9.520	
cash		9.520

Discount amortization schedule

- Morgan then amortizes the discount & recognized interest revenue annualy.

	Cash received	Interest revenue	Disc amortized	Carrying amount note
Date of issue				9,520
End of year 1	1,000(a)	1,142(b)	142(c)	9,662(d)
End of year 2	1,000	1,159	159	9,821
End of year 3	1,000	1,179	179	10,000
	3,000	3,480	480	

a) 10,000 x 10% = 1,000
b) 9,520 x 12% = 1,142
c) 1,142 – 1,000 = 142
d) 9520 + 142 = 9,662

Interest receiv	1,000	
Notes receivable	142	
interest revenue		1,142

RECONCILIATION OF BANK BALANCE

- Deposits in transit
- Outstanding checks
- Bank charge
- NSF
- Bank Credits
- Bank or Depositor errors

- To illustrate, Nuggets Mining Co. books show a cash balance at Melbourne Bank on November 2017 $ 20,502. the bank statement covering the month of November show an ending balance $22,190. an examination of Nuggets accounting record & November bank statement identified the following transaction:
  1. A deposit of $3,680 that nugget mailed November 2017 does not appear on the bank statement
  2. Checks written in November but not changed to the November bank statement are: check # 7327 $ 150, #7348 $4,820, #7349 $ 31
  3. Nugget has not yet recorded the $600 of interest collected by the bank November 20 on Sequoia Co. bond held by the bank for nugget
  4. Bank service charge of $18 are not yet recorded on nugget book
  5. The bank returned of one of nugget customer check for $220 with the bank statement marked NSF
  6. Nugget discovered that it in correctly recorded check #7322 written in November for 131 in payment of an account payable as $311
  7. A Check for a Nugget Co. in the amount of $175 that the bank incorrectly changed to Nugget accompanied the statement

NUGGET MINING CO				
BANK RECONCILIATION				
MELBOURNE BANK, 30 NOV				
Balance per bank statement				22,190
ADD	Deposit intransit	(1)	3,680	
	Bank error	(7)	175	3,855
				26,045
DEC	Outstanding Checks	(2)		(5,001)
Correct Cash Balance				**21,044**
Balance per book				20,502
ADD	interest revenue	(3)	600	
	error in recording check	(6)	180	780
				21,282
DEC	Bank serv charge	(4)	(18)	
	NSF	(5)	(220)	(238)
Correct cash balance				**21,044**

Valuation of inventories: a cost-basis approach

Learning objectives

- After studying this chapter, you should be able to:
  - Identify major classification of inventories
  - Distinguish between perpetual and periodic inventory systems
  - Identify the effect of inventory errors on the financial statement
  - Understand the items to include as inventory cost
  - Describe and compare the methods used to price inventories

Preview of chapter 8

Chapter 8

Inventory issue
- Classification
- Cost flow
- Control
- Basic inventory valuation

Physical goods included in inventory
- Goods in transit
- Consigned goods
- Special sales agreement
- Inventory errors

Cost included in inventory
- Product cost
- Period cost
- Purchase discount

Cost flow assumption
- Specific identification
- Average cost
- FIFO
- Summary analysis

Classification

- Inventories are asset items that a company holds for sale in the ordinary course of business
- A merchandising concern such as carefour (FRA) ussually purchases its merchandise in a form ready for sale (only one inventory account)
- A manfacture concern three inventory account, raw material, work in process, finished goods

Inventory cost flow

Determining cost of goods sold

Beginning inventory	100.000
Cost of good acquired during year	800.000
Cost of available for sale	900.000
Ending inventory	(200.000)
CoGs	700.000

COMPARING PERPETUAL & PERIODIC SYSTEMS

Beginning inventory	100 units at $6	=	$600
Purchase	900 units at $6	=	$5,400
Sales	600 units at $12	=	$7,200
Ending inventory	400 units at $6	=	2,400

perpetual			periodic		
1. Beginning inventory					
The inventory count shows the inventory on hand $600					
2. Purchase 900 units					
Inventory	5,400		Purchase	5,400	
Account Payable		5,400	Account Payable		5,400
3. Sale of 600 units					
Account Receivable	7,200		Account Receivable	7,200	
Sales		7,200	Sales		7,200
CoGS (600x6)	3,600		No entery		
Inventory		3,600			
4. End of period					
No entery			Inventory (ending)	2,400	
			CoGS	3,600	
			Purchase		5,400
			Inventory (beginning)		600

INVENTORY CONTROL

- For various reasons, management is vitally interested in inventory planning & control. Whether a company manufactures or merchandises goods, it needs an accurate accounting system with up-to-date records.
- Companies like Loblaw Co. Ltd (CAN), Woolworth (AUS) Sainsbury (GBR) use perpetual inventory systems.
- However, many companies cannot afford a complete perpetual system. But most of these companies use modified perpetual inventory system
- With the use of "just in time" inventory order systems and better supplier relationships, many companies have leaner inventory levels

BASIC INVENTORY VALUATION

- Valuing inventories can be complex. It requires determining the following:
  1. The physical goods to include in inventory (who own the goods? –goods in transit- consigned goods-special sales agreement)
  2. The cost to include the inventory (perpeptual vs. Periodic)
  3. The cost flow assumption to adopt (specific identification, average cost, FIFO, retail)

Goods in transit

General rule	
Inventory is buyer's when received, except:	
FOB shipping point	Buyer's at time of delivery to common carrier
Consignment goods	Sellers's not buyer's
Sales with buybacks	Sellers's not buyer's
Sales with high rates of returns	Buyer's, if you can estimate returns
Sales on instalement	Buyer's if you can estimate collectability

Consigned goods

- Companies market certain product through a consignment shipment.
- Companies agrees to accept the goods without any liability, except to exercise due care & reasonable protection from loss or damage, until it sells the goods to a third party.

Special sales agreement

- Sales with buyback agreement
- Sales with high rates of return
- Sales on installement

Average , FIFO, LIFO

Beginning cash balance		7.000
Beginning retained earning		10.000
Beginning inventory	4.000 units @$3	12.000
Purchase	6.000 units @$4	24.000
Sales	5.000 units @$12	60.000
Operating expense		10.000
Income tax rate		40%

	Average Cost	FIFO	LIFO
Sales	$60,000	$60,000	$60,000
Cost of goods sold	18,000[a]	16,000[b]	20,000[c]
Gross profit	42,000	44,000	40,000
Operating expenses	10,000	10,000	10,000
Income before taxes	32,000	34,000	30,000
Income taxes (40%)	12,800	13,600	12,000
Net income	$19,200	$20,400	$18,000
	[a]4,000 @ $3 = $12,000 6,000 @ $4 = $24,000 $36,000 $36,000 ÷ 10,000 = $3.60 $3.60 × 5,000 = $18.000	[b]4,000 @ $3 = $12,000 1,000 @ $4 = $ 4,000 $16,000	[c]5,000 @ $4 = $20,000

Notice that gross profit and net income are lowest under LIFO, highest under FIFO, and somewhere in the middle under average cost.

Illustration 8A-4 shows the final balances of selected items at the end of the period.

	Inventory	Gross Profit	Taxes	Net Income	Retained Earnings	Cash
Average Cost	\$18,000 (5,000 × \$3.60)	\$42,000	\$12,800	\$19,200	\$29,200 (\$10,000 + \$19,200)	\$20,200[a]
FIFO	\$20,000 (5,000 × \$4)	\$44,000	\$13,600	\$20,400	\$30,400 (\$10,000 + \$20,400)	\$19,400[a]
LIFO	\$16,000 (4,000 × \$3) (1,000 × \$4)	\$40,000	\$12,000	\$18,000	\$28,000 (\$10,000 + \$18,000)	\$21,000[a]

[a]Cash at year-end	=	Beg. Balance	+	Sales	−	Purchases	−	Operating expenses	−	Taxes
Average cost—\$20,200	=	\$7,000	+	\$60,000	−	\$24,000	−	\$10,000	−	\$12,800
FIFO—\$19,400	=	\$7,000	+	\$60,000	−	\$24,000	−	\$10,000	−	\$13,600
LIFO—\$21,000	=	\$7,000	+	\$60,000	−	\$24,000	−	\$10,000	−	\$12,000

As indicated, LIFO results in the highest cash balance at year-end (because taxes are lower). This example assumes that prices are rising. The opposite result occurs if prices are declining.

Inventories:
Additional valuation issues

Dekeng Setyo Budiarto, Dr, Ak, CA

Keiso, Weygandt & Warfield “Intermediate Accounting IRFS Ed” third edition, Wiley, Singapore

Learning Objectives

01 Describe

Describe and apply the lower of cost or net realizable value rule

02 Identify

✓Identify other inventory valuation issues

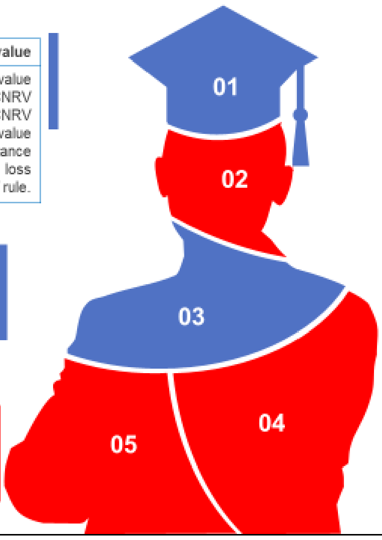
03 Determine

✓Determine ending inventory by applying the gross profit method
✓Determine ending inventory by appling the retail inventory method.

04 Explain

✓Expalin how to report and analyze inventory.

Preview of Chapter 9



Lower of cost or net realizable value
- Net realizable value
- Illustration of LCNRV
- Application of LCNRV
- Recording net realizable value
- Use of an allowance
- Recovery of inventory loss
- Evaliation of rule.

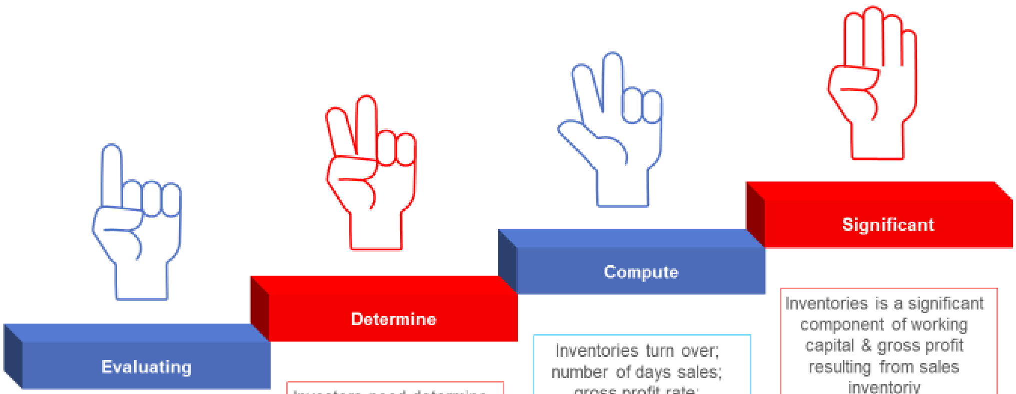
Valuation Bases
- ✓ Net realizable value
- ✓ Relative standalone sale value
- ✓ Purchase commitments

Gross profit method
- Gross profit %
- Evaluation of method.

Retail inventory method
- ✓ Cocept
- ✓ Conventional method
- ✓ Special items
- ✓ Evaluation method.

Presentation & Analysis
- Presentation of inventories
- Analysis of inventories.

Not what it seems to be



Investor need comparable information about inventories when evaluating a retailer's financial statements

Investors need determine what inventories method a retailer using (FIFO, average?)

Inventories turn over; number of days sales; gross profit rate; current ratio

Inventories is a significant component of working capital & gross profit resulting from sales inventoriy

Net realizable value

$950

Mander has unfinished inventories with cost $950, a sales value $1.000,

$750

Mander reports inventories $750 on financial statement

Inventory value unfinished		1.000
Less: estimated cost of completion estimated cost to sell (950-750)	50 200	
Net realizable value		750

60%

Inventories are recorded at their cost. However, if it declines in value below its original cost, a major departure from the historical cost principles occurs. Whatever the reason for a decline- obsolence, price level change, or damage, a company should writedown net realizable value

Lower of cost or net realizable value (LCNRV)

Food	cost	Net realizable value	Final inventory value
Spinach	80.000	120.000	80.000
Carrots	100.000	110.000	100.000
Cut bean	50.000	40.000	40.000
Peas	90.000	72.000	72.000
Mix vegetables	95.000	92.000	92.000
			384.000

01 **Final inventory value**
Spinach & carrots are selected because it is lower than NRV

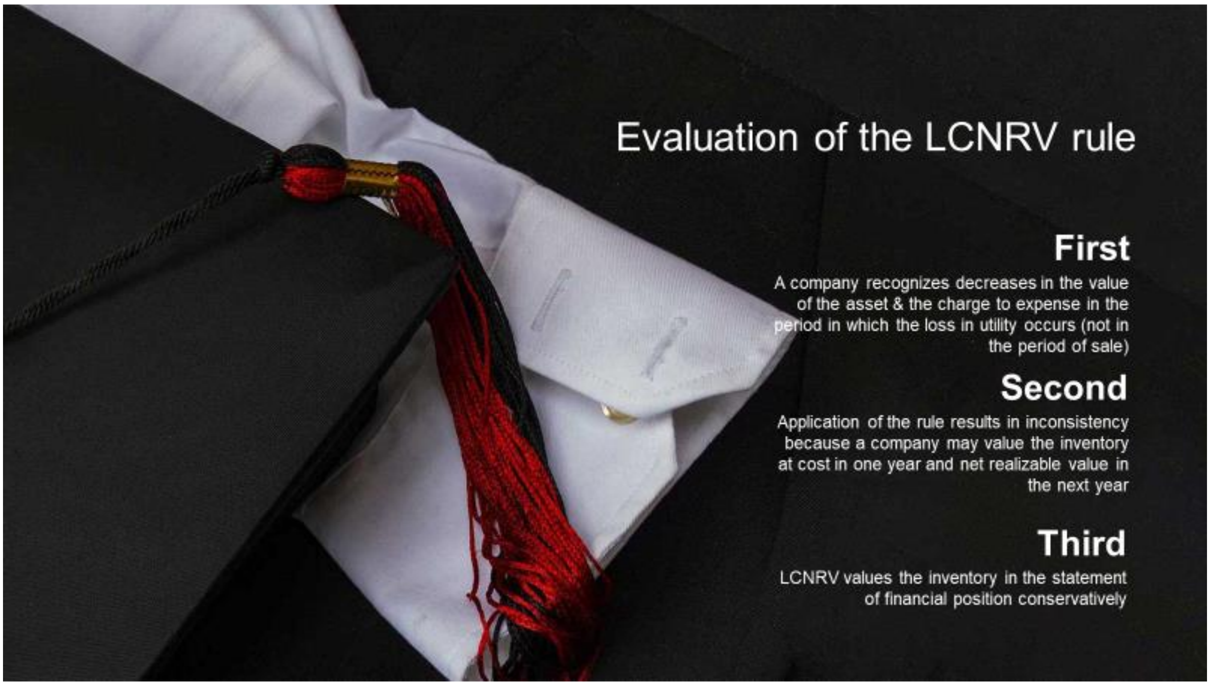
02 **Final inventory value**
Cut bean, peas, mix vegetables is selected because it is lower than cost.

Recording net realizable value instead of cost

Cost of good sold	108.000
Ending inventory (cost)	82.000
Ending inventory (net realizable value)	70.000

12.000

Cost of good sold method		Loss method	
To reduce inventory from cost to net realizable value			
Cost of good sold	12.000	Loss due to decline	12.000
inventory	12.000	inventory	12.000



Gross profit method

Auditors widely use this method in situation where they need only an estimate of the company's inventory with 3 assumption:

First:

abcd@company.com
Facebook.com/abcd
Twiter.com/abcd

The beginning inventory + purchases equal total goods tobe accounted for

Second:
Goods not sold must be on hand

Third

abcd@company.com
Facebook.com/abcd
Twiter.com/abcd

The sales reduced to cost, deducted from the sum of the opening inventory + purchases equal ending inventory

Gross profit method

Beginning inventory (at cost)		60.000
Purchase at cost		200.000
Goods available (at cost)		260.000
Sales (at selling price)	280.000	
Gross profit (30% * 280.000)	(84.000)	
Sales (at cost)		196.000
Aproximate inventory (at cost)		64.000

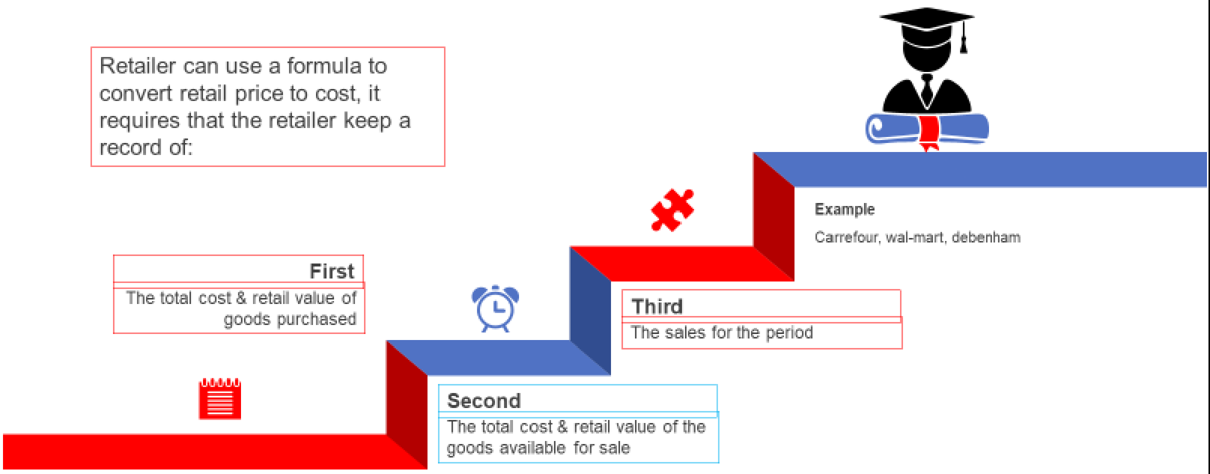
Gross profit persentage

Sales revenue		280.000
Cost of sales		
beginning inventory	60.000	
purchase	200.000	
goods available for sale	260.000	
ending inventory	(3) ??	
Cost of goods sold		(2) ??
Gross profit on sales		(1) ??

(1) 280.000 * 30% = 84.000
(2) 280.000 - 84.000 = 196.000
(3) 260.000 -196.000 = 64.000

Retail inventory method

Retailer can use a formula to convert retail price to cost, it requires that the retailer keep a record of:



Retail inventory method

	Cost	Retail
Beginning Inventory	14.000	20.000
Purchases	63.000	90.000
Goods available for sale	77.000	110.000
(Sales)		85.000
Ending inventory		25.000

Ratio of cost to retail (77.000/110.000) = 70%
Ending inventory at cost (70% * 25.000) = 17.500

Retail inventory method (markups & markdown)

	Cost	Retail
Beginning Inventory	500	1.000
Purchases (net)	20.000	35.000
Markups		3.000
Markups cancellation		(1.000)
Markdown		2.500
Markups cancellation		(2.000)
		25.000

Ending inventory at retail x cost ratio = value of ending inventory
Assumption A => 12.500 * 53.9% = 6.737
Assumption B => 12.500 * 54.7% = 6.837

	cost		Retail
Beginning Inventory	500		1.000
Purchases (net)	20.000		35.000
Merchandise available for sale	20.500		36.000
Add: markups		3.000	
Less: murkups cancellation		(1.000)	
Net markups			2.000
	20.500		38.000
A => cost to retail ratio (20.500/38.000)= 53.9%			
Deduct			
Markdowns		2.500	
Markdown cancellation		(2.000)	
Net markdown			500
	20.500		37.500
B=> cost to retail ratio (20.500/37.500)= 54.7%			
Deduct: sales (net)			25.000
Ending inventory at retail			12.500

Acquisition & Disposition of PPE

Chapter X

Dekeng Setyo Budiarto, Dr, Ak, CA

Learning objectives

- Indentify PPE and its related cost
- Discuss the accounting problems associated with interest capitalization
- Explain accounting issues related to acquiring & valuing plant assets
- Describes the accounting treatment for cost subsequent to acquisition
- Describes the accounting treatment for disposal of PPE

Preview of chapter 10

Acquisition & disposition of PPE

- PPE:
  - -Acquisition
  - -Costing
  - -Self-constructed assets
- Interest cost during construction
- Valuation of PPE
- Cost subsequent to acquisition
- Disposition of PPE

The major characteristics of PPE are follows:

They are acquired for use operations & not for sale

Long term in nature & usually depreciated

They possess physical substance

Acquisition of PPE

Most companies use historical cost as the basis for valuing property, plant & equipment

Historical measures the cash or cash equivalent price of obtaining the asset and bringing it to the location & condition necessary for its intended use.

Companies recognize PPE when the cost of the asset can be measured reliably & it is probable that the company will obtain future economic benefit

Fair value is relevant to inventory but less so for PPE which are held for use in the business, no for sale like inventory

Cost of PPE

Land costs typically include:

- The purchase price;
- Closing costs;
- Cost incurred in getting the land (grading, filling, draining & clearing);
- Assumption of any liens, mortgages or encumbrance;
- Any additional land improvements that have an indefinite life

Cost of building include:

- Materials, labor & overhead costs incurred during construction
- Professional fees & building permit

Cost of equipment:

- Purchase price;
- Freight & handling charge incurred;
- Insurance the equipment while in transit;
- Cost of special foundations if required;
- Assembling and installation cost

Interest cost during constructions

- Capitalize no interest charge
- Charge construction with all cost of funds
- Capitalize only the actual interest

Valuation of PPE

- Deffered payment contracts
- Greathouse co. purchase an asset $ 100.000 zero interest bearing note payable 5 years 10%. They payoff $ 20.000 installments

Deffered payment contracts

Date of Purchase			
	Equipment Notes Payable *PV: 20.000(PVF-OA,5,10%) 20.000(3.790) table 75.816	75.816	 75.816
End of First Year			
	Interest expense Note Payable Cash	7.582 12.418	 20.000
End of Second Year			
	Interest expense Note Payable Cash	6.340 13.660	 20.000

Valuation of PPE

- Exchanges-loss situation
- IP trade, Inc. trades its used machine for a new model at Jerrod business solution. The exchange has commercial substance. The used machine has book value of $8.000 (original cost $12.000-$4.000 acc. depr) and fair value of $6.000 for the use machine.

List price of new machine	**16.000**
less: trade in allowance for use machine	**9.000**
Cash payment due	7.000
Fair value of used machine	6.000
Cost of new machine	13.000

Fair value of used machine	**6.000**
less: BV of used machine	**8.000**
Loss on disposal	2.000

Equipment	13.000	
ACC depr	4.000	
Loss of disposal	2.000	
Equipment		12.000
Cash		7.000

- Exchange gain solution
- Interstate change a number of used truck plus cash for semi-truck. The used truck have of combine book value of $42.000 (cost $64.000-$22.000 acc. Depr). Interstate purchasing agent, experienced in the second-hand market, indicate that the used truck have a fair value of $49.000. in addition to the truck, interstate must pay $11.000 cash for the semi-truck.

Fair value of truck exchanged	**49.000**
Cash paid	**11.000**
Cost of semi-truck	60.000

Fair value used truck		49.000
Cost of used truck	64.000	
Less: acc depr	(22.000)	
Less: BV of used truck		42.000
Gain of disposal		7.000

Truck (semi)	60.000	
ACC depr	22.000	
Truck (used)		64.000
Gain of disposal		7.000
Cash		11.000

Cost subsequent to acquisition

- Hanoi enterprises decided to replace the iron pipes in its plumbing system. The old pipe have BV 15.000 (cost of 150.000-135.000 acc depr) & residual value 1.000. the new plastic tubing cost 125.000. if Hanoi pays 124.000, it makes following entry:

Equipment (new)	125.000	
ACC Depr-Equipment	135.000	
Loss on disposal	14.000	
Equipment (old)		150.000
Cash		124.000

Disposition of PPE

- Sale of plant assets
- Baret company recorded depreciation on a machine costing \$18.000 for 9 years at \$1.200/ year. If it sell the machine in the middle of 10^{th} for \$7.000:

Depreciation expense	600	
accumulated depreciation		600

Cash	7.000	
Acc depr (1.200x9) + 600	11.400	
Machine		18.000
gain on disposal		400

Daftar Pustaka

Keiso, D.E., Weygandt, J.J., & Warfield, T.D. (2018) Intermediate Accounting, IFRS Edition, Third Edition, Willey, Singapore