

AFA100: Introductory Financial Accounting

Financial Accounting (2017), Sixth Canadian Edition, by Libby, Libby, Short, Kanaan & Sterling. McGraw Hill

FUNDAMENTAL ACCOUNTING EQUATION:

$$ASSETS = LIABILITIES + OWNER'S EQUITY$$

Financial Statements

Balance Sheet (Statement of Financial Position)

Sample:

ABC Corporation			
Statement of Financial Position			
For the year ended December 31, 2020			
Assets			Liabilities
Current Assets			Current Liabilities
Cash	\$ 1,000		Accounts Payable
Accounts Receivable	5,000		Notes Payable (Short-term)
Inventory	6,000		1,000
Prepaid Insurance	5,000		6,000
Supplies	1,000	18,000	
			Non-current Liabilities
Non-current Assets			Notes Payable (Long-term)
Property, Plant, Equipment	100,000		45,000
			Total Liabilities
			51,000
			Shareholder's Equity
			Contributed Capital
			57,000
			Retained Earnings
			10,000
			Total Shareholder's Equity
			67,000
Total Assets	\$ 118,000	Total Liabilities & Shareholder's Equity	\$ 118,000

- Underline each subtotal, double underline the total assets and liabilities & shareholders' equity
- Title and subtitle as well as current and non-current assets/liabilities
- Common practices:
 - Order accounts in terms of liquidity
 - Total each section (current, non-current)

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Income Statement (Profit and Loss) – Single Step

XYZ Corporation Inc.

Income Statement

For the Year Ended December 31, 2020

Revenues

Sales Revenues	\$	100,000	
Interest Revenue		<u>5,000</u>	
Total Revenue			\$ 105,000

Expenses

Cost of Goods Sold		10,000	
Depreciation Expense		5,000	
Wages Expense		2,500	
Rent Expense		1,000	
Interest Expense		500	
Supplies Expense		250	
Utilities Expense		<u>100</u>	
Total Expenses			\$ <u>19,350</u>

Net Income \$ 85,650

- For a single step, COGS would be under “Expenses”
- Multi-step is different (refer to example below)

Multi-step Income Statement

- Revenues – COGS – Sales Discounts, Returns, and Allowances = Gross Profit
- Operating Expenses
- Non-operating Expenses afterwards
- Earnings per share at the bottom

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Adjusting Entries

Type	Explanation	Adjusting Entry
Deferred Revenues	Previously recorded liabilities that were created when cash was received in advance and that must be reduced to the amount of revenue actually earned during the period	Ex. Dr Deferred Revenue Cr Revenue
Accrued Revenues	Revenues that have been earned but not yet recorded because cash will be received after the services are performed or goods are delivered	Ex. Dr Accounts Receivable Cr Revenue When received: Dr Cash Cr Accounts Receivable
Deferred Expenses	Previously recorded assets, such as prepaid rent, supplies, and equipment that were created when cash was paid in advance and that must be reduced to the amount of expenses actually incurred during the period through the use of the asset	Ex. Dr Rent Expense Cr Prepaid Rent
Accrued Expenses	Expenses that have been incurred but not yet recorded because cash will be paid after the goods or services are used.	Ex. Dr Wages Expense Cr Wages Payable

Closing the Books

Example:

To close Revenue, we input into Income Summary as such:

Dr Revenue
Cr Income Summary

To close expenses:

Dr Income Summary
Cr Expenses

Then, we put Income Summary into Retained Earnings:

Dr Income Summary
Cr Retained Earnings

Sales Revenue

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Revenue recognition principle:

1. The entity has transferred to the buyer the significant risks and rewards or ownership of the goods
2. The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold
3. The amount of revenue can be measured reliably
4. It is probable that the economic benefits associated with the transaction will flow to the entity
5. The costs incurred or to be incurred with respect to the transaction can be measured reliably

Bad debt expense

Is the expense associated with estimated uncollectible accounts receivable. It is recorded through an *adjusting journal entry at the end of the accounting period*. If I estimated bad debt expense to be \$500, the entry would be:

Dr Bad Debt Expense 500
Cr Allowance for Doubtful Accounts 500

Throughout the year, when it is determined that a customer cannot pay its debt, we must write off the account as such:

Dr Allowance for Doubtful Accounts AMT
Cr Accounts Receivable AMT

A **bank reconciliation** is the process of comparing and verifying the accuracy of both the ending cash balance in the company's records and the ending cash balance reported by the bank on the monthly bank statement. This should be done to each separate chequing account.

The most common causes of differences between the ending bank balance and the ending book balances of cash are:

1. **Bank service charges** - an expense for bank services listed on the bank statement. This expense is not recorded on the company's books.
2. **NSF cheques** - a "bad cheque" or "bounced cheque" that was deposited but must be deducted from the company's cash account and recorded as a receivable
3. **Interest** - the interest paid by the bank to the company on its bank balance
4. **Deposits in transit** - deposits sent to the bank by the company and recorded in the company's ledger as debits to the cash account. The bank has not recorded these deposits (they are not shown on the bank statement as an increase in the bank balance). Deposits in transit are determined by comparing the deposits listed on the bank statement with the copies of the deposit slips retained by the company or other company records.
5. **Outstanding cheques** - cheques written by the company and recorded in the company's ledger as credits to the cash account that have not cleared the bank
6. **Errors** - Both the bank and the company may make errors, especially when the volume of cash transactions is large

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The following steps can be made to preparing a bank reconciliation:

1. **Identify bank charges and credits not recorded on the company's books**
2. **Identify the deposits in transit**
3. **Identify the outstanding cheques**
4. **Determine the impact of errors**

Afterwards, we can prepare a bank reconciliation statement which corrects the cash balance for both the company's books and bank statement. We would then adjust the accounts through journal entries. For example, if we were to receive interest in our bank statement and we have not yet recorded it:

Dr Cash
 Cr Interest Revenue

Or, if we had a NSF cheque received from John Smith:

Dr A/R
 Cr Cash

Cost of Sales

Beginning Inventory + Purchases of merchandise during the year = Cost of Goods Available for Sale
– Ending Inventory = Cost of Sales

Perpetual Inventory System

Ex. Purchasing inventory:

Dr Inventory
 Cr Payables

If we want to return some inventory:

Dr Payables
 Cr Inventory

If we have discounts:

Dr Payables
 Cr Inventory NET OF DISCOUNT
 Cr Cash After discounts