

Chapter 4

Closing Process

Closing entries formally recognize in the ledger the transfer of net income (or net loss) and Dividends to Retained Earnings. Companies generally journalize and post closing entries only at the end of the annual accounting period. Closing entries produce a zero balance in each temporary account.

Permanent account and temporary account.

Permanent: balance sheet items (all asset, liability, and stockholders' equity)

Temporary: income statement and statement of retained earnings items (Revenue, expenses, and dividend).

Closing

Transfer the revenue and expenses accounts to income summary, and then transfer income summary to retained earnings. Transfer dividend to retained earnings directly.

The end balance of Income Summary (right before closing it) equals to the net income (of the given period).

After closing, all temporary accounts should have the balance of ZERO (check the T-account and trial balance).

Compare the unadjusted trial balance, adjusted trial balance, and the post-closing adjusted trial balance (check all temporary accounts and the ending balance of retained earnings).

Classified Balance Sheet

The correct order of presentation in a classified balance sheet for the following current assets is: cash, accounts receivable, inventory, prepaid insurance.

Current Liabilities: Obligations the company is to pay within the coming year or its operating cycle, whichever is longer.

Liquidity- ability to pay obligations expected to be due within the next year. (long-term: after 1 yr.)

Stockholders' (Owner's) Equity

Proprietorship - one capital account.

Partnership - capital account for each partner. Corporation - Common Stock and Retained Earnings.

Chapter 5

Merchandising Operations and Inventory Systems

Operating Cycles: The operating cycle of a merchandising company ordinarily is longer than that of a service company.

Merchandise Company (Buy & Sell Goods) vs
Manufacturing Company

Equation:

Sales Revenue - Cost of Goods Sold = Gross Profit - Operating Expenses = Net Income (loss)

Flow of Costs

Concept of Perpetual inventory system and periodic inventory system.

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 the cost of goods sold each time a sale occurs.

Periodic System

- Do not keep detailed records of the goods on hand.
- Cost of goods sold is determined by count at the end of the accounting period.

Equation:

Beginning Inventory + Cost of Goods Purchased = Cost of Goods available for Sale

Cost of Goods available for Sale = Cost of Goods Sold + Ending Inventory

Recording Purchases of Merchandise:

- Freight Costs
- Purchase Returns and Allowances
- Purchase Discounts (What are Credit Terms?)

Example: credit terms 2/10, n/30, which is read "two-ten, net thirty". This means that the buyer may take a 2% cash discount on the invoice price, less ("net of") any returns or allowances, if payment is made within 10 days of the invoice date (the discount period).



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Chapter 5 (cont)

Recording Sales of Merchandise

Accounts Receivable
-----Sales Revenue
Cost of Goods Sold
-----Inventory

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

Multiple-Step Income Statement

- Shows several steps in determining net income.
- Two steps relate to principal operating activities.
- Distinguishes between operating and non-operating activities.

Key terms:

- Sales revenue
- Net sales
- Gross profit
- Operating expenses
- Nonoperating activities
- Net income

Chapter 6

Inventories

Concept of inventory

Inventory refers to the ASSETS a company (1) intends to sell in the normal course of business, (2) has in production for future sale (work in process), or (3) uses currently in the production of goods to be sold (raw materials).

Determining Inventory Quantities

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.

Determining ownership of goods:

-Good in transits:

- a) FOB Shipping Point: Ownership of the goods passes to the buyer when the public carrier accepts the goods from the seller.
- b) FOB Destination: Ownership of the goods remains with the seller until the goods reach the buyer.

-Consigned Goods

Inventory is accounted for at cost.

Cost includes all expenditures necessary to acquire goods and place them in a condition ready for sale.

Four methods:

Specific identification (1 method)

Cost flow assumptions (3 methods)

-FIFO (assumes that the earliest goods purchased are the first to be sold)

-LIFO (assumes that the latest goods purchased are the first to be sold)

-Average cost

Statement Presentation:

-Ending inventories: Balance sheet (current assets)

-COGS: Income statement (subtracted from sales)

Chapter 8

Receivables

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

Accounts Receivable:

Amounts customers owe on account that result from the sale of goods and services.

Notes Receivable:

Written promise for amounts to be received. Normally requires the collection of interest.

Other Receivables:

Nontrade receivables such as interest, loans to officers, advances to employees, and income taxes.

Valuing Accounts Receivable

Uncollectible Accounts (Bad Debts)

Companies keep a separate accounts receivable account for each customer (called a **subsidiary account**). The amount on the balance sheet represents the total of these individual customer accounts.

Bad debts result from credit customers who will not pay the amount they owe, regardless of collection efforts.



Chapter 8 (cont)

Allowance Method (following GAAP):

Accounts receivable

Allowance for doubtful (or uncollectible) accounts (this is a contra-asset account)

Expected cash realizable value = Accounts receivable - Allowance for doubtful accounts

Allowances for doubtful accounts: a reserve that could be drawn when accounts cannot be repaid.

Bad Debt Expense (or uncollectible account expense) incurred when the uncollectible accounts are estimated, not when someone fails to pay back.

Chapter 7

Fraud, Internal Control, and Cash

Cash: assets (e.g., coins, bank savings, checking, etc.)

ex: cash on hand, cash in banks, and petty cash

Cash equivalents are short-term, highly liquid investments that are both:

1. Readily convertible to known amounts of cash
2. So near their maturity that their market value is relatively insensitive to changes in interest rates.

ex: Treasury bills, commercial paper (short-term corporate notes), and money market funds.

Restricted Cash:

Cash that is not available for general use but rather is restricted for a special purpose. Cash restricted in use should be reported separately on the balance sheet as restricted cash.

Fraud

Dishonest act by an employee that results in personal benefit to the employee at a cost to the employer.

Fraud triangle

(three factors: opportunity, financial pressure, rationalization)

Internal Control

Methods and Measures Adopted To:

1. Safeguard assets.
2. Enhance the reliability of accounting records.
3. Increase efficiency of operations.
4. Ensure compliance with laws and regulations.

Five Primary Components:

1. A control environment.
2. Risk assessment.
3. Control activities.
4. Information and communication.
5. Monitoring.

Cash Receipts and Disbursements Controls

Cash Disbursements Controls

Generally, internal control over cash disbursements is more effective when companies pay by check or electronic funds transfer (EFT) rather than by cash.

Voucher System Controls: record and file a voucher, which is an authorization form prepared for each expenditure.

Petty Cash Fund:

Used to pay small amounts.

Limitations of Internal Control

- Costs should not exceed benefits.
- Human element.
- Size of the business.

How to calculate the interests?

$$\text{Face Value of Note} \times \text{Annual Interest Rate} \times \text{Time in Terms of One Year} = \text{Interest}$$

