

Economic Consequences of Accounting

- on wealth or behavior of
 - lenders and investors
 - reporting entities, their management and users of financial statements
 - reporting entities and standard setters
- Sources of impact
 - Effect of financial results reported in the financial statements
 - Effect of firm's choice of accounting principles
 - Effect on reporting entities of standard setters' decisions
 - Effect on standard setters of their decisions

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Quality of Earnings

- Business: having stable and recurring basic revenue generating activities
- Accounting: 1) using consistent estimates and rules
 - High: same methods of estimation and rules
 - » 2) proximity of revenue recognition and cash collection
 - High: when revenue recognition and cash collection are close
- High quality earnings are presumed to be fair representations of the economic performance of the firm
- Low quality earnings overstate fair earnings

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What will affect Quality of Earnings?

- Managers' discretion in measuring and reporting earnings in:
 - Choosing among alternative accounting principles
 - Making estimates
 - Timing transactions in order to control recognition

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Why is Current Asset Management Important?

- solvency
- profitability
- profitable but insolvent
- quality of receivables
- credit policies
- idle cash

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Cash and Cash Equivalents

- **Cash**
 - Coins, banknotes deposits at banks, checks received from customers
 - **Restricted Cash** or **Blocked Cash** and the related amounts should not be included in the cash amount
 - **Petty Cash**
- **Cash Equivalents**
 - Investments that are readily convertible to cash with insignificant risk and with a maturity less than 90 days- e.g. Treasury Bills, term-deposits with less than 90 days maturity

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Checks Received From Customers

- by law, checks are payable at sight, so they are deemed as liquid and should be included as cash in the balance sheets of the entities
- although the concept of post dated checks is not within the context of the legislation, in practice checks with future payment dates are issued in Turkey
- due-dated checks should not be included as cash but treated as notes receivable in the balance sheet.

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Control Over Cash

- easily transportable
- large number of transactions involving cash
- Establish Responsibilities
- Segregation of Duties
- Documentation Controls
- Physical Controls
- Independent Internal Verification
- Use of Bank Accounts

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Receivables

- Accounts Receivable
 - Notes Receivable
 - Other Receivables

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Recognition of Accounts Receivable

- accrual basis of accounting- sales revenue is recognized at the time a sale is made and the title of ownership of the items under the sale passes to the buyer regardless of the cash payment date
- when sales are made on credit the accounts receivable is recognized and recorded at the invoice amount when a sale is realized

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Valuation of Receivables-IFRS

- a risk that a customer will not pay or will not be able to pay its debt
- IFRS -accounts receivable should be valued at their net realizable value (or net recoverable amount)
- **Net Realizable Value** represents the amount of cash expected to be collected from the receivables
- net recoverable amount of accounts receivable (*or trade receivables*) is equal to their original values unless there is an indication of impairment
- **Entities should assess at each balance sheet date whether there is objective evidence that an account receivable may be impaired, and determine the amount of allowance that should be estimated based on the net realizable value or the discounted cash flow from such receivable**
- **TAX- when it is certain that a customer is not going to pay write-off the account *i.e. erase from the accounts and record it as a loss**

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Impairment of Accounts Receivable-IFRS

- Matching principle and losses estimated from selling on credit
- Some possible indications of impairment are as follows:
 - If there is a sign that the customer has financial difficulty,
 - If there is a high probability of bankruptcy of the customer,
 - If the customer delays its payments,
 - If the customer asks for extension of the payment period, and
 - If the economy in general or the industry the customer operates in suffers from financial difficulties
- under IAS 39, general provisions are not permitted and all impairment of trade receivables must be measured using a discounted cash flow methodology

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Impairment Loss

- measured as the difference between the original or the carrying value of the receivable and the present value of estimated cash flows discounted at the original effective interest rate of the receivable
- effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected collection date of the receivable to the net carrying amount of the receivable
- Allowance for Uncollectible Accounts account
 - accumulates the estimated losses
 - contra-asset account
 - deducted from Accounts Receivable in order to determine the net realizable value of receivables
 - replenished every period
 - decreases by the realization of loss due to customer default through the write off process

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How much is the expense?

- difference between total of net recoverable amount of accounts receivable and the total invoice amount represents the targeted balance for the Allowance for Uncollectible Accounts
- adjusting entry to record the impairment loss on accounts receivable should bring the balance of the Allowance for Uncollectible Accounts to the amount estimated from the impairment of accounts receivable

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Adjusting Entries – target impairment loss known- Case 1

Allowance for Uncollectible Account Balance is a credit of TL 2.950
Estimated (target) Allowance for Uncollectible Accounts TL 4.183CR
Balance of Allowance for Uncollectible Accounts Before Adjustment 2.950CR
Estimated Impairment Loss TL 1.233

Date	Account Title and Description	Debit	Credit
31-Dec-08	Impairment Loss on Accounts Receivable	1.233	
	Allowance for Uncollectible Accounts		1.233
	To record impairment loss of accounts receivable		

Balance Sheet Representation

Accounts Receivable	TL 59.750
Allowance for Uncollectible Accounts	<u>4.183</u>
Net Realizable Value of Accounts Receivable	TL 55.567

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Adjusting Entries – target impairment loss known- Case 2

Allowance for Uncollectible Account Balance is credit of TL 6.283
Balance of Allowance for Uncollectible Account Before Adjustment TL 6.283CR
Estimated Allowance for Uncollectible Accounts 4.183CR
Recovery of Impairment Loss TL 2.100

Date	Account Title and Description	Debit	Credit
31-Dec-08	Allowance for Uncollectible Accounts	2.100	
	Recovery of Impairment Loss		2.100
	To record the recovery of impairment loss		

Balance Sheet Representation

Accounts Receivable	TL 59.750
Allowance for Uncollectible Accounts	<u>4.183</u>
Net Realizable Value of Accounts Receivable	TL 55.567

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Write Off of Accounts Receivable

- a specific customer is not able to pay its debt

Risk A.Ş. declared bankruptcy on 20 March 2009

Date	Account Title and Description	Debit	Credit
20-Mar-09	Allowance for Uncollectible Accounts	5.450	
	Accounts Receivable-Risk A. Ş		5.450
	To write off the receivable from Risk A.Ş.		

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Recovery of Receivables Written Off

Risk A.Ş. informed Sağlam Yapı Market that it will pay TL 3.000 of its total debt on 3 April 2009 and the remaining amount later

Date	Account Title and Description	Debit	Credit
3-Apr-09	Accounts Receivable- Risk A.Ş.	5.450	
	Allowance for Uncollectible Accounts		5.450
	To recover the written off receivable from Risk A.Ş.		
3-Apr-09	Cash	3.000	
	Accounts Receivable- Risk A.Ş.		3.000
	To record collection from Risk A.Ş.		

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Direct Write-off

Dekorasyon A.Ş. sold furniture at TL1.000 to Mr. Aksoy in December 2004 with terms n/60. However, Mr. Aksoy was in financial difficulty and informed Dekorasyon A.Ş. that he bankrupted in May 2005. Since it became evident that this receivable cannot be collected, Dekorasyon A.Ş. decided to write off the receivable.

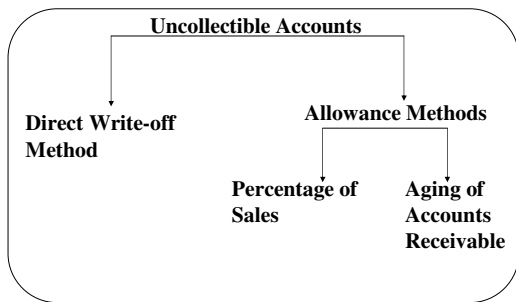
Date	Account Title and Description	Debit	Credit
May 31 2005	Uncollectible Account Expense	1.000	
	Accounts Receivable-Mr. Aksoy		1.000
	To record receivable from Mr. Aksoy as Uncollectible Account Expense		

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Accounting for Uncollectible Accounts-FASB



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Financing with Accounts Receivable

- Pledge of Accounts Receivable - used as a guarantee in credit arrangements with financial institutions to receive loans-IFRS requires that pledge agreements should be disclosed in the notes to the financial statements
- Factoring Accounts Receivable- selling receivables to get cash before the maturity (due date) of the receivables
- Credit Card Sales

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Factoring Accounts Receivable

- With recourse - factor can collect the receivable from the seller if the customer does not pay the receivable – risk with lies with the company
- Without recourse -risk of non-payment of the customer lies with the factor
- Based on the risks involved rates differ
- In the case of with recourse factoring the entity may become liable to the factor - this contingent liability should be disclosed in the notes to the financial statements

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Factoring-with recourse-Factor entries

Date	Account Title and Description	Debit	Credit
3-Mar-08	Accounts Receivable	3.500	
	Financing Revenue		175
	Due to Fashion Giyim Sanayi		200
	Cash		3.125
	To record the sale of accounts receivable to Firm Factoring		

Firm Factoring-a customer defaulted:

Date	Account Title and Description	Debit	Credit
5-Sep-08	Due to Fashion Giyim Sanayi	100	
	Accounts Receivable- Yagmur Men.		100
	To record the default of an accounts receivable		

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Factoring with recourse-payment date

Assume none of the customers take sales discount and by 15 December 2008 Firm Factoring collects all accounts receivable and pays Fashion Giyim Sanayi the remaining amount.

Fashion Giyim Sanayi will make the following entry

Date	Account Title and Description	Debit	Credit
15-Dec-08	Cash	100	
	Due from Firm Factoring		100
	To record receipt of amount withheld by the		

Firm Factoring

Date	Account Title and Description	Debit	Credit
15-Dec-08	Due to Fashion Giyim Sanayi	100	
	Cash		100
	To record payment of the amount withheld by the		

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Credit Card Sales

Gourmet Restaurant served dinner to various customers on 11 May 2007 and collected TL 750 with the credit cards. Gourmet Restaurant's agreement with INVO Bank to collect the credit card slips is 21 days with 5% interest rate

Date	Account Title and Description	Debit	Credit
11-May-07	Receivable from INVO Bank	712,5	
	Commission Expense		37,5
	Revenues		750
	To record the dinner served on 11 May 2007		
1-Jun-07	Cash	712,5	
	Receivable from INVO Bank		712,5
	To record the collection from INVO Bank		

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Notes Receivable

- A promissory note is an unconditional promise to pay a certain amount of money in the future.
 - To borrow money
 - To settle an accounts receivable
- notes with maturity dates less than or equal to 12 months are classified as short-term

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Promissory Note-(IOU)

PROMISSORY NOTE	
TL 8.300 Amount	2-Jun-08 Date
For value received, I promise to pay to the order of Health Pharmacy Ankara Turkey	
the amount of <i>Eight thousand three hundred Turkish Lira</i>	
On	120 days after date
Plus	interest at an annual rate of 25%.
Animal Co. Ankara Turkey	

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Accounting Entries Illustrated for Notes Receivable-1

When the Note Received

Date	Account Title and Description	Debit	Credit
2-Jun-08	Notes Receivable	8.300	
	Accounts Receivable		8.300
	To record the notes received from Animal Co.		

At the end of the Fiscal Year

Date	Account Title and Description	Debit	Credit
31-Aug-05	Interest Receivable	518,75	
	Interest Income(*)		518,75
	To accrue for the interest on notes receivable		

(*) Interest: $8.300 \times 25\% \times 90 \text{ days} / 360 \text{ days} = \text{TL } 518,75$

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Accounting Entries Illustrated for Notes Receivable-2

When the Note is Paid

Date	Account Title and Description	Debit	Credit
30 Sept.	Cash	8,991,67	
2008	Notes Receivable		8,300,00
	Interest Income		172,92
	Interest Receivable		518,75
To record the collection of the note			

If the Note is Dishonored

Date	Account Title and Description	Debit	Credit
30 Sept.	Accounts Receivables	8,991,67	
2008	Notes Receivable		8,300,00
	Interest Income		172,92
	Interest Receivable		518,75
To record the dishonored note			

Other Current Assets

- Value Added Taxes Deductible and Carried Forward
- Advances Given
- Prepaid Taxes
- Prepaid Expenses

Common Financial Ratios Used in Management of Current Assets

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Quick Ratio} = \frac{(\text{Cash and Cash Eqvt} + \text{Accounts and Notes Rec.} + \text{Short term Security Investments})}{\text{Current Liabilities}}$$

$$\text{Accounts Receivable Turnover} = \frac{\text{Net Sales}}{\text{Average Accounts Receivable}}$$

$$\text{Collection Period} = \frac{365}{\text{Accounts Receivable Turnover}}$$



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