

Module 6: Current financial assets and current liabilities

Overview

In this module, you learn about the nature of certain financial assets and current liabilities, including their characteristics, classification, control of cash, and the reasons for bank reconciliations. You also learn about receivables, both trade and non-trade, as well as the methods of accounting for bad debts. Finally, you have an opportunity to apply what you have learned by preparing an accounts receivable aging schedule using Excel.

Test your knowledge

Begin your work on this module with a set of [test-your-knowledge questions](#) designed to help you gauge the depth of study required.

Topic outline and learning objectives

- [6.1](#) [Nature of financial assets and liabilities](#)
Describe the nature of financial instruments. (Level 1)

- [6.2](#) [Cash](#)
Define and account for cash, and explain the features of an effective internal control system. (Level 1)

- [6.3](#) [Receivables](#)
Describe the nature of accounts receivable, and apply IFRS in accounting for these assets. (Level 1)

- [6.4](#) [Accounting for bad debt expense](#)
Calculate bad debt expense and explain its effect on financial statements. (Level 1)

- [6.5](#) [Notes receivable](#)
Describe the nature of notes receivable and apply IFRS in accounting for this asset. (Level 1)

- [6.6](#) [Current liabilities](#)
Describe the nature of current liabilities, and apply IFRS in accounting for these liabilities. (Level 1)

- [6.7](#) [Computer illustration 6.7-1: Aging of accounts receivable](#)
Prepare an AR aging report using a worksheet. (Level 1)

- [6.8](#) [Managing working capital](#)
Describe factors to be considered in managing working capital. (Level 2)

[Module summary](#)



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Substantive differences between IFRS and the pre-IFRS *CICA Handbook* that apply to this module

IFRS standards referenced	Comparable pre-IFRS CICA Handbook sections	Comments
IAS 1 <i>Presentation of Financial Statements</i>	1510 Current Assets and Current Liabilities	<p>Section 1510 is less comprehensive than IAS 1 because IAS 1</p> <p>(i) requires presentation in order of liquidity when such presentation provides information that is reliable and more relevant; and</p> <p>(ii) requires current classification of breached long-term liabilities unless refinancing is complete by the balance sheet date.</p> <p>There may be significant differences in presentation.</p>
IAS 1 <i>Presentation of Financial Statements</i>	3020 Accounts and Notes Receivable	These standards are converged – no significant conflicts.
IAS 39 <i>Financial Instruments – Recognition and Measurement</i>	3855 Financial Instruments – Recognition and Measurement	<p>Section 3855 and IAS 39 are converged, except that IAS 39:</p> <p>(i) restricts the circumstances in which the option to measure a financial instrument at fair value through profit or loss is available;</p> <p>(ii) requires quoted loans to be measured at fair value through profit or loss, whereas Section 3855 classifies these as loans and receivables and accounts for them at amortized cost (other than debt securities, which may be classified as held for trading, held to maturity or available for sale);</p> <p>(iii) requires all available-for-sale financial assets to be measured at fair value unless fair value is not</p>

reliably determinable, whereas Section 3855 requires non-quoted equity instruments classified as available for sale to be measured at cost;

(iv) requires foreign exchange gains and losses on available-for-sale financial assets to be recognized immediately in net income;

(v) does not allow a choice of accounting policy for transaction costs;

(vi) does not address financial instruments exchanged or issued in related party transactions;

(vii) requires reversal of impairment losses in some circumstances; and

(viii) has no scope exceptions for non-publicly accountable enterprises and not-for-profit organizations.

There can be significant differences for some entities with particular fact situations.

Test your knowledge Module 6

The questions below from the Online Learning Centre (OLC) for the *FA2* textbook address some of the core issues for this module. You may find it useful to go through these questions before you attempt the module as it may aid you in assessing the areas that you need to focus on.

[Chapter 7: Multiple Choice Quiz](#)

6.1 Nature of financial assets and liabilities



Learning objective

- Describe the nature of financial instruments. (Level 1)



Required reading

- Chapter 7, pages 333–334 up to "Accounting for Cash" (Level 1)

LEVEL 1

In the first five modules of this course, you studied the three major financial statements and some of the main accounting concepts and principles supporting the preparation of these statements. In the remaining modules in this course and in *FA3*, you will take a more in-depth look at the components of the balance sheet. *FA2* concentrates on the assets, *FA3* on liabilities and shareholders' equity.

The text gives a brief overview of monetary items. The Handbook section on monetary items that the text was based on was superseded by a definition of financial instruments. IAS 32 defines financial instruments as follows:

DEFINITIONS

11 The following terms are used in this Standard with the meanings specified:

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

A financial asset is any asset that is:

- (a) cash
- (b) an equity instrument of another entity;
- (c) a contractual right:
 - (i) to receive cash or another financial asset from another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

A *financial liability* is any liability that is :

- (a) a contractual obligation:
 - (i) to deliver cash or another financial asset to another party; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

The definitions section then goes on to identify specific categories of financial instruments and liabilities, including the following: financial asset or financial liability at fair value through profit or loss (held for trading); held-to-maturity investments; loans and receivables; and available-for-sale financial assets. You study loans and receivables in this module and the other categories in future modules.

6.2 Cash



Learning objective

- Define and account for cash, and explain the features of an effective internal control system. (Level 1)



Required reading

- Chapter 7, pages 334–337 up to "Accounting for Receivables" and pages 368–372 up to "Questions" (Level 1)

LEVEL 1

The text describes what constitutes cash, how it is valued, and necessary control features. Cash is the most liquid of all assets; the most desirable; and one of the easiest to steal. As such, a prudent business must implement stringent controls to safeguard this asset.

Activity 6.2-1 – Bank reconciliation

In this activity, you apply what you have learned about cash accounts and preparing a bank reconciliation by answering a case question. After completing your response, compare it to the suggested solution.

Case question: Retail Company

Retail Company recently hired you as a junior accountant. Retail is a closely held, medium-sized retailing firm. One of your first assignments is to prepare the June bank reconciliation. You find the following information from the June bank statement and company records:

Deposits in transit	\$7,200
Balance per bank statement	16,500
Bank service charges	30
Outstanding cheques	9,750
NSF cheque returned	3,000
\$3,300 deposit incorrectly recorded by the company as	3,030

Your immediate supervisor, the chief accountant for the company, who also has limited cash disbursement responsibilities, tells you the unadjusted balance of cash per the ledger at the end of June is unavailable. However, he must have the reconciliation immediately for a report to the vice-president of finance. He also asks you to reduce the above outstanding cheques by \$2,600 "to adjust for certain errors before you were hired."

Accompanying the bank statement are cancelled cheques. Among them is a \$2,600 cheque written to an individual not employed by the company, signed by your superior.

Required:

- Assuming that the information in the above list is correct and complete, prepare the June bank reconciliation.
- Why might the superior have withheld information and made his unusual request for adjusting the bank reconciliation?
- Discuss your options and responsibilities in this situation, including ethical considerations and possible effects on you.

Source: Chapter 7, Case 1, Additional Case Question, Online Learning Centre, *Intermediate Accounting*, Volume 1, 3rd edition, 2005, Copyright McGraw-Hill Ryerson. Reproduced and

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[Solution](#)

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6.3 Receivables



Learning objective

- Describe the nature of accounts receivable, and apply IFRS in accounting for these assets. (Level 1)



Required reading

- Chapter 7, pages 337–339 up to "Allowance for Doubtful Accounts" (Level 1)

LEVEL 1

The text outlines the process for the recognition and measurement of accounts receivable. While not explicitly mentioned, accounting for this asset is provided for in the standards set out in section IAS 39 defines loans and receivables as

non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than:

- (a) those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;
- (b) those that the entity upon initial recognition designates as available for sale; or
- (c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

IAS 39 p46 then stipulates that "loans and receivables as defined in paragraph 9, which shall be measured at amortised¹ cost using the effective interest method."

Receivables, then, are assets that normally arise from the delivery of goods or services that are measured at amortized cost. Amortized cost is defined in IAS 39 p9. For receivables, it is the initial present value of the receivable adjusted to reflect the passage of time. At first glance, this treatment appears to be materially different from the "old" manner of accounting for receivables as in *FA1*, where you learned that the time value of money was ignored and the receivables were carried at face value due to materiality and cost benefit considerations. The IFRS financial instruments standard for accounting for receivables is not significantly different, however, as paragraph 79 of the application guidance for IAS 39 reads in part: "Short-term receivables and payables with no stated interest rate may be measured at the original invoice amount if the effect of discounting is immaterial. "In practice, this means that most accounts receivables are reported at their face value.

¹ IFRS uses British spelling such as *amortised*, whereas the commonly accepted Canadian spelling is *amortized*. As direct quotations are faithfully reproduced, you will see British spelling used throughout the module notes wherever IFRS standards are quoted.

6.4 Accounting for bad debt expense



Learning objective

- Calculate bad debt expense and explain its effect on financial statements. (Level 1)



Required reading

- Chapter 7, pages 339–349 up to "Notes Receivable and Payable" and the "International Perspective" insert on page 363 (Level 1)

An unfortunate by-product of selling on credit terms is that not everyone pays you back! Remember that one criterion of revenue recognition was that "it is probable that the economic benefits associated with the transaction will flow to the entity" [IAS 18 p14(d), 20(b), and 29(a)]. To satisfy this requirement, companies estimate the amount of receivables that they will not collect and charge this amount to bad debt expense. By taking this step, the companies can recognize revenue on credit sales at the time of delivery.

The text discusses three ways to provide for bad debts:

- the aging method
- the credit sales method
- the direct write-off method

The aging method is a balance sheet approach; the bad debt expense recognized is a by-product of the receivables at balance sheet date. The credit sales method is tied to the income statement; the bad debt expense is directly related to the level of credit sales. Unless the amounts are immaterial, the direct write-off method does not comply with IFRS.

Non-trade receivables

Receivables other than trade receivables are usually classified as non-trade or other receivables. This classification includes items such as

- claims against trade creditors for damaged or lost goods
- dividends receivable
- claims against insurance companies for losses sustained
- advances to officers and employees

Only those other receivables that are related to the operating cycle or are collectible within one year should be reported as current assets. Because non-trade receivables are valued at their estimated realizable amounts, a special allowance for doubtful accounts for this category may be warranted.

Transfer/sale of accounts receivables

The primary thrust of the pre-IFRS *CICA Handbook* (as set out in the text) and IFRS with respect to accounting for the transfer and/or sale of accounts receivables is the same. As suggested in the International Perspective insert, though, the two sets of standards differ in their approach and this may impact on the manner in which the sale is accounted for. Briefly, IFRS focuses on whether substantially all the risks and rewards of ownership have been transferred, while the pre-IFRS *CICA Handbook* concentrated on the surrendering of control of the transferred asset.

The text establishes that there are three ways that a company can raise money from its receivables:

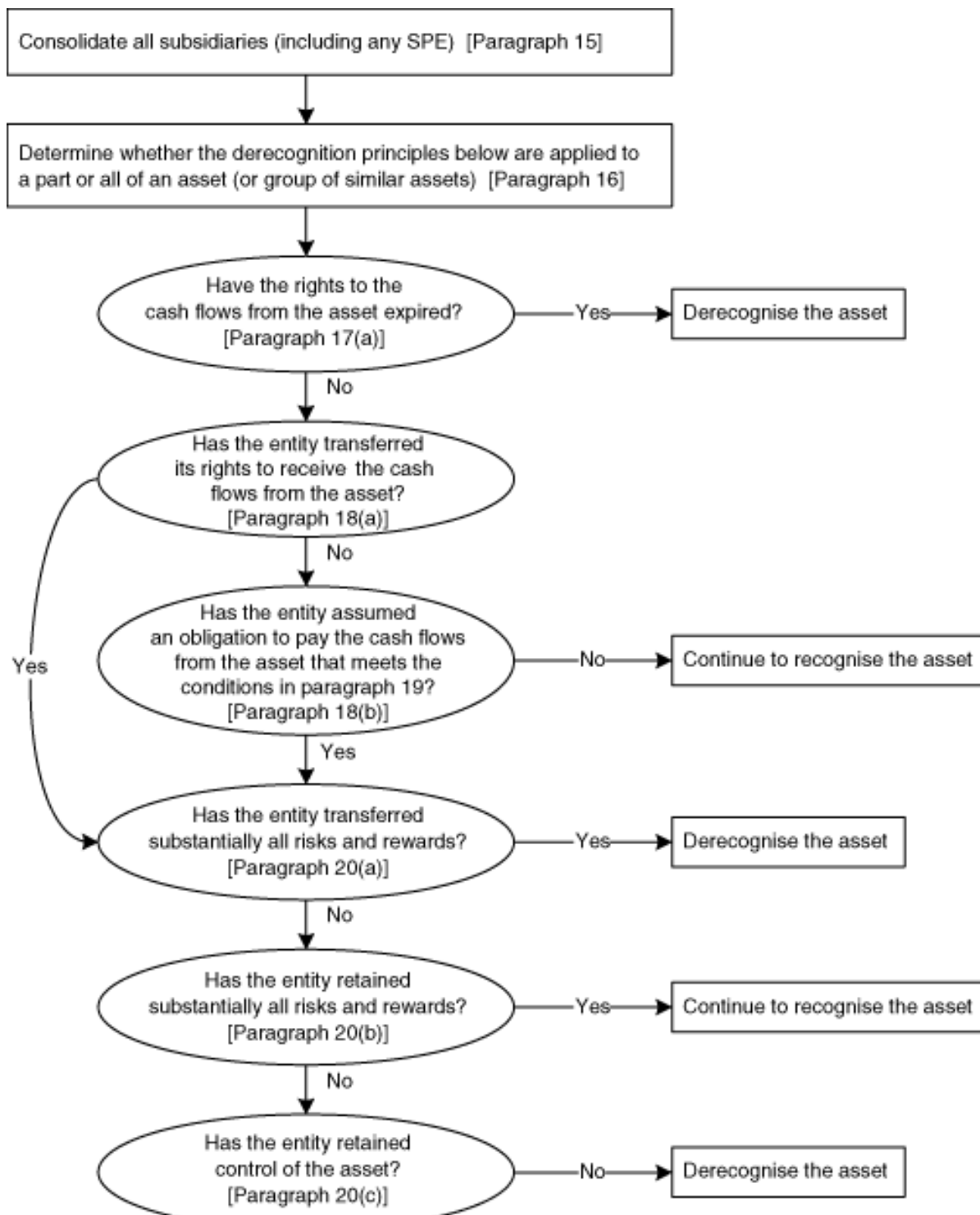
1) The company can pledge them as security and borrow against them. Because this is a loan, there is nothing special that needs to be done from an accounting standpoint, other than to disclose in the notes to the financial statements that the accounts receivable have been pledged as security.

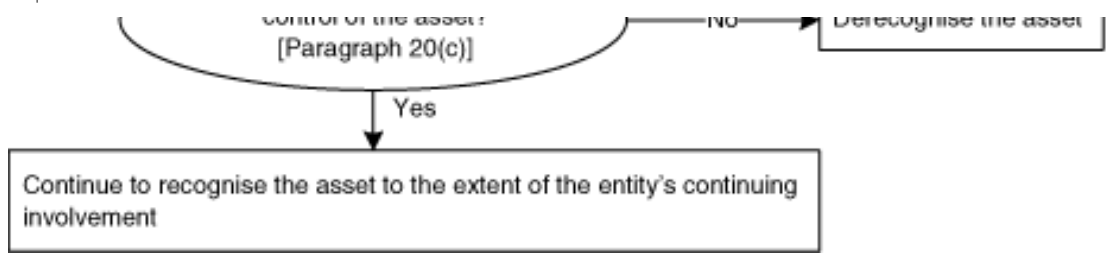
2) They can be sold without recourse. As the text suggests, this is a sale of assets. As such, the receivables are removed from the seller's books, the consideration received is recorded, and the difference is charged to interest expense.

3) They can be sold with recourse. While this is also a sale of assets, the purchaser can require the seller to reimburse them for losses over a predetermined level. Whether the seller has retained substantially all risks and rewards [paragraph 20(b)] or whether the entity has retained control of the asset [paragraph 20(c)] is a matter of professional judgment based on how the underlying contract is structured. Given the highly technical nature of this area, **accounting for the transfer or sale of accounts receivables on a recourse basis is non-examinable.**

When receivables are sold, the accounting treatment is determined by the derecognition of a financial assets provision in IAS 39 p15–37. The requisite accounting treatment is summarized in a flow chart in IAS 39 AG36 reproduced below:

AG36 The following flow chart illustrates the evaluation of whether and to what extent a financial asset is derecognised.





6.5 Notes receivable



Learning objective

- Describe the nature of notes receivable and apply IFRS in accounting for this asset. (Level 1)



Required reading

- Chapter 7, pages 349–356 (Level 1)

LEVEL 1

The text sets out the accounting treatment for notes receivables.

Notes receivable are financial assets and, as such, must be measured in accordance with IAS 39. This standard requires that most notes receivable be initially valued at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset. Notes receivable are subsequently measured at their amortized cost, which is defined in IAS 39 p9 as

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

Textbook errors

On page 354 and elsewhere the text discusses the straight-line method of amortizing discounts. IAS 39 p9 requires that the effective interest method be used.¹ **You are required to use the effective interest rate method on all assignment, quiz, and examination questions.**

¹ The implicit suggestion is that if the results are not materially different, then it is acceptable to invoke materiality and use the straight-line method. While true, you should not lose sight of the fact that all IFRS may be overridden on the basis of immateriality. At this stage in your financial accounting education, you should focus on what IFRS is and how to apply it, rather than possible alternatives to be used if the resulting differences are immaterial.

6.6 Current liabilities



Learning objective

- Describe the nature of current liabilities, and apply IFRS in accounting for these liabilities. (Level 1)



Required reading

- Chapter 7, pages 357–365 (Level 1)

LEVEL 1

Most current liabilities are settled by paying cash. Not all obligations are cleared up in this manner, though. Unearned revenue and warranty obligations are examples of liabilities that will be settled by the transfer of assets or providing services.

Many liabilities contain both current and long-term components; the distinguishing feature is the anticipated settlement date. For example, a firm that provides a three-year warranty would use the expected claim pattern to determine the amount of the provision that would be recorded as a current obligation. Similarly, the principal amount due in the next 12 months on a long-term loan is recorded as a current liability.

6.7 Computer illustration 6.7-1: Aging of accounts receivable



Learning objective

- Prepare an AR aging report using a worksheet. (Level 1)

LEVEL 1

This computer illustration demonstrates how an accounts receivable aging schedule can be prepared using a worksheet.

Material provided

A file, FA2M6P1, containing a partially completed worksheet M6P1 for your work, and a solution worksheet M6P1S.

Description

An aged trade accounts receivable worksheet (M6P1 in the file FA2M6P1) is prepared as at December 31, 2009. The worksheet calculates the number of days a particular receivable has been outstanding and classifies the receivable into one of five aging categories:

- 0–30 days
- 31–60 days
- 61–90 days
- 91–180 days
- 180+ days

For each outstanding receivable, the worksheet also calculates the weighted amount outstanding (days outstanding × receivable amount).

Data

Three receivables have been pre-entered in the worksheet. You will enter the following receivables into the worksheet:

Account name	Due date	Balance
Fine Furnishings	Dec. 11, 09	\$ 134
ABC Plumbing	Dec. 01, 09	\$ 214
Lorna's Fashions	Nov. 04, 09	\$ 168
Exotic Florist	Oct. 14, 09	\$ 406
Better Printing	Sep. 21, 09	\$ 246
Cambridge Drugs	Sep. 02, 09	\$ 337
Netto Cleaners	May 17, 09	\$ 278

Required

Complete the aged accounts receivable worksheet M6P1.

Procedure

1. Start Excel.
2. Open the file FA2M6P1 and click on the sheet tab M6P1. Move to cell C10 and read the formula =J\$6-\$B10+1. This formula subtracts the content of cell B10 from cell J6 and adds 1 to the difference. Note the use of absolute cell reference. If you are unfamiliar with absolute cell reference, refer to CT2 . Note also that two dates can be subtracted from each other, resulting in the number of days the dates are apart.
3. Move the cell pointer to cell E10 and examine the formula \$C10*F10. This formula multiplies the number of days (cell C10) with the amount outstanding for 0-30 days (cell F10). Next, examine the formula in cell F10:

=IF(AND(C10>0,C10<31),\$D10,0)

This formula determines whether the content of cell C10 (days outstanding) is greater than 0 and less than 31 (0-30 days). If it is, it places the amount from cell D10 (the balance) in the current cell; otherwise, it places a 0 in the current cell.

4. Review the formulas in the pairs of cells G10 and H10, I10 and J10, K10 and L10, and M10 and N10. Notice that they are similar to the formulas in the cell pairs E10 and F10.
5. Review the formulas in rows 20, 21, and 22. For example, the formula in cell F20, =SUM(F10:F19), computes the total amount outstanding for 0-30 days. The formula in cell F21, =SUM(E10:E19), computes the total amount outstanding, weighted by the number of days in the 0-30 days bracket. The results in row 21 (Weight Total) are used to calculate the average number of days outstanding, weighted by the amount due in row 22.
6. Enter the account name, due date, and balance for each of the receivables listed at the beginning of this illustration, starting with Fine Furnishings in cell A13. In cell B13 enter the date of **12/11/2009**, and in cell D13 enter the amount **134** (no preceding \$ sign).
7. Complete the entry of the rest of the receivable amounts in columns A, B, and D.
8. Copy the formula in column C from cell C12 to cells C13 to C19. In columns E through N, copy the formulas in row 12 to rows 13 to 19. Also, enter the necessary formulas in cells J22, L22, and N22.
9. After you have entered all the outstanding receivables and formulas, save the file under your own initials.
10. Print a copy of the completed worksheet.
11. Click the sheet tab for M6P1S. Compare the results from the worksheet printed in step 10 with the solution worksheet. Make any necessary corrections.

6.8 Managing working capital



Learning objective

- Describe factors to be considered in managing working capital. (Level 2)

As discussed in Topic 3.1, it is vitally important that a company have sufficient cash at hand, or available to it through credit lines, to be able to meet its obligations when due. To achieve this, a company must successfully manage its working capital, an integral part of which is preparing a cash-based budget.

The primary components of working capital are usually cash, accounts receivable, inventory, accounts payable, and short-term credit facilities provided by banks or other financial institutions. To be meaningful, a cash budget must consider all of these aspects.

Looking at each of these in turn:

1. Setting the ideal bank balance involves trade-offs. Cash sitting in a bank account is largely a non-productive resource because the interest that you will earn, if any, is negligible. If you have too much cash in your account, it means that you are foregoing other more profitable investment opportunities. Too little cash means that you are unable to pay your bills on time, are unable to take advantage of special deals as they present themselves, and do not have a cushion to protect yourself in case of unforeseen, adverse developments.

2. The firm must establish a credit policy that factors in market conditions, competitive factors, and the firm's ability to arrange financing on an ongoing basis for the resultant receivables. That is, if you do not sell on credit, or have a very restrictive credit policy, then you will have few receivables and minimal bad debt expense. While this is very positive from the perspective of managing working capital, it remains that you will undoubtedly lose sales to your competitors who have more liberal credit terms. If on the other hand, you have very liberal credit policies, you will certainly make sales that you would not otherwise. But the resultant receivables may be of questionable quality, and unless you make some offsetting arrangements, you may generate insufficient cash from your sales to meet your obligations in a timely manner. For example, you may be able to arrange with one or more of your suppliers for extended payment terms so as to ease, or at least defer, your cash outflow requirements. Note, though, that arranging for additional credit is not an adequate substitute for maintaining strict control of your receivables.

3. The danger of having too little inventory is that you run out of stock and lose sales as a result. The downside of having too much inventory includes the cost of financing, storing, and insuring it, and the increased risk of obsolescence. Like setting a credit policy, there are definite trade-offs involved here.

4. The policy on accounts payable would seem to be straightforward; drag them out as long as possible so as to preserve cash and get "free" credit. But is this really the best policy? Perhaps the vendor is willing to offer you better terms if you pay in a more timely manner, including offering cash discounts for early payment. Also, if there is a scarcity of the product, the vendor is more likely to sell to the company that pays promptly.

5. Most well established firms do arrange for short-term credit facilities, by way of note or overdraft, to help in managing their working capital. Typically, the bank will establish a line of credit, the availability of which is determined by the company's level of receivables and inventory. (Though there are no preset formulas, many operating line facilities provide that the bank will lend you a maximum of 75% of your qualifying accounts receivable and 50% of your inventory.) While it is prudent to establish a line of credit, you cannot count on this to solve your working capital issues. What if the bank decides not to lend to you, or gives you a lower line of credit than you would like? Moreover, even if the bank grants you a credit line, its lending formula or "margin" seldom ever provides for 100% financing of the securing items. For example, if you have receivables of \$100,000, the bank may lend you \$75,000; this is fine, unless you have \$100,000 in bills to pay.

The discussion above is not meant to be exhaustive. Rather, it is a brief outline of some of the many variables that must be considered when establishing a working capital policy.

Preparing a cash budget is only a preliminary step, however. Even the most carefully prepared budgets are, at best, educated guesses, and the actual results usually differ from those forecast, sometimes materially. As such, it is vital that the company monitor its results on an ongoing basis and take corrective action on a timely basis when significant deviations exist. The nature of the remedial action will, of course, be determined by the circumstances and factor in the options available to the

company. It may be something as simple as having the A/R clerk phone clients who are past due and ask them for payment; it may be more substantive, such as holding a clear-out sale of overstocked inventory items at substantially discounted prices.

Module 6 summary

Current financial assets and current liabilities

This module describes the nature of certain financial assets and current liabilities. The characteristics, classification, and control of cash and the reasons for bank reconciliations are explained. Receivables, both trade and non-trade, are defined and their classification explained. The methods of accounting for bad debts are illustrated.

Describe the nature of financial instruments.

- A *financial instrument* is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. (IAS 32 p11)

Define and account for cash, and explain the features of an effective internal control system.

- Cash is the amount of coin, currency, bank deposits, and certain types of formal negotiable instruments such as cheques and money orders.
- The cash reported as a current asset includes only the cash available for current use. If cash is restricted from current use, it should not be reported as a current asset.
- An effective internal control system is a set of policies and procedures designed to
 - protect assets
 - ensure compliance with laws and company policy
 - provide accurate accounting records
 - evaluate performance

Describe the nature of accounts receivable, and apply IFRS in accounting for these assets.

- Accounts receivable represent receivables due from regular customers and arising from the sale of goods or services on trade terms.
- Short-term accounts receivable arising from the sale of goods and services are normally carried at their face amount less an allowance for bad and doubtful accounts.
- Short-term accounts receivables are not discounted to their present value unless the effect is material.

Calculate bad debt expense and explain its effect on financial statements.

- Bad debt expense should be provided for in the period of the sale in accordance with the matching principle.
- At the end of each period, an allowance should be established for those accounts not expected to be collected.
- Bad debts expense is usually estimated using the credit sales method or the aging method.

Describe the nature of notes receivable and apply IFRS in accounting for this asset.

- Notes receivable represent written promises to pay specified amounts on specified date(s). Most notes receivables are initially valued at their fair value plus directly attributable transaction costs and subsequently measured at their amortized cost less any reduction for impairment or uncollectibility.
- Discounts and premiums are amortized using the effective rate method.

Describe the nature of current liabilities, and apply IFRS in accounting for these liabilities.

- Current liabilities should include obligations that will be settled by the transfer of assets or providing services within

one year from the date of the balance sheet or within the operating cycle, whichever is longer.

- Obligations should be excluded from the current liability classification to the extent that contractual arrangements have been made for settlement from other than current assets.

Describe factors to be considered in managing working capital.

- An integral part of managing working capital is preparing a cash based budget.
- The primary components of working capital are usually cash, accounts receivable, inventory, accounts payable, and short-term credit facilities provided by banks or other financial institutions. To be meaningful, a cash budget must consider all of these aspects.

Solution**Suggested Answer:
Chapter 7 – Additional Case Key Points: Retail Company****Requirement a****Bank Reconciliation**

June 30

	<i>Per bank</i>	<i>Per books</i>
Balances, June 30	\$16,500	?
Deposits in transit	7,200	
Outstanding cheques	(9,750)	
Error		270
NSF cheque		(3,000)
Service charge		(30)
True Cash Balance	\$13,950	\$13,950

The unadjusted balance per books (?) must therefore be \$16,710.

Requirement b

In his position as chief accountant with some cash disbursement authority, your supervisor has an inappropriate combination of responsibilities. He has the ability to record transactions and also has access to cash. These should normally be segregated. The company's system of internal control should be revamped.

Although insufficient information is given in the case, the facts seem to imply that the chief accountant had earlier written an unauthorized cheque, and is now destroying all evidence of it.

The withholding of information about the unadjusted cash balance conceals the effect of the \$2,600 cheque on the cash balance. The chief accountant may not have recorded the cheque as a reduction in the cash balance. The cash balance per ledger would then be overstated by \$2,600. However, the bank balance would reflect the \$2,600 cleared cheque. In the bank reconciliation, the requested reduction in the outstanding cheque amount would offset the \$2,600 reduction in the bank balance. The reconciliation would therefore show the correct cash balance, in this case \$13,950. If the chief accountant had not also withheld information on the ledger balance, the books to true cash portion of the reconciliation would not have balanced.

Requirement c

The chief accountant has taken advantage of his position and has placed you, as a new hire, in a difficult position. You have three options: (1) comply with the request, (2) refuse and do nothing further, and (3) approach a higher level of authority within the company to discuss the situation.

One of the main principles in ethics is that everyone bears some responsibility for the well-being of everyone else. To concede some satisfaction for the sake of helping another is a basic tenet in ethics. In this case, you have a responsibility to the shareholders of the firm to make the chief accountant's request known to another level of authority within the organization. We favour the third alternative. This option does not necessarily imply that you believe some wrongdoing has

occurred.

You are undoubtedly aware that your action may hurt your position. On the other hand, top management may look favourably on your whistle-blowing. In the context of internal control and preparation of a bank reconciliation, the situation calls at a minimum for clarification.

You are a CGA student and the chief accountant is a CGA. A CGA student's ethical responsibilities as set out in CGA-Canada's Code of Ethical Principles and Rules of Conduct (CEPROC) are basically equal to that of a CGA.

Because CGA students are bound by CEPROC, the Deceptive Information part of CEPROC's Ethical Principles area applies. This section includes a requirement that "Members shall not be associated with any information which the member knows, or ought to know, to be false or misleading, whether by statement or omission." You should take steps to satisfy yourself that the information is, in fact, correct. This would usually involve seeking a satisfactory explanation from the chief accountant, and if this was not forthcoming, discussing the matter with a higher level of authority. Since the chief accountant is a CGA, then matters become somewhat more involved. Specifically, the Responsibility to Society part of the Rules of Conduct directs that

R104 Breach of Rules

A member shall, subject to Rule R105 and Rule R201, notify the Association of any breach of the *Code of Ethical Principles and Rules of Conduct* by another member, or any other situation of which the member has sufficient knowledge which appears to put in doubt the competence, reputation or integrity of members. [Rule 201 deals with the confidentiality aspect.]

R105 Criticism of a Professional Colleague

A member shall not criticize another professional colleague without first submitting this criticism to that colleague for explanation. Where the criticism may result in a complaint against the colleague being lodged with the Ethics Committee, the member must, where required, first submit that criticism in writing to the colleague for explanation. The member thereafter shall inform that colleague as to the action the member has taken concerning the criticisms. The lodging of an Ethics complaint against a professional colleague is considered a criticism under this rule.

Given the facts in the case, it does not appear that you have as yet met the "sufficient knowledge" test. As such, you should seek to clarify the situation by asking for a more satisfactory explanation from the chief accountant. If the chief accountant refuses or is unable to provide a reasonable explanation, you may argue that as a CGA student you have "sufficient knowledge" and as such must follow the guidance in Rules 104 and 105. This is a matter not to be taken lightly, however, and would normally only be pursued after further investigation and considerable deliberation.

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