I. WORKING CAPITAL AND ITS COMPONENTS
   
   A. Introduction
      1. Working capital is a measure of the solvency of an entity. The current ratio and quick ratio are used for analysis purposes.
      2. Current assets and liabilities generally must meet the one-year test.
   
   B. Cash and Cash Equivalents
      1. Cash must be readily available. Cash equivalents are highly liquid investment securities with maturity dates within 90 days of the date purchased. The only occasion when time to maturity matters is at the purchase date.
      2. Restricted cash must be segregated from other cash.
      3. Bank reconciliations reconcile ending balances per bank and books, adding and subtracting items causing differences between the two balances. Outstanding items are adjustments on the bank side and adjusting journal entry information provides adjustments on the book side.
   
   C. Accounts Receivable
      1. Valuing accounts receivable requires reductions for bad debts, sales returns and allowances, and sales discounts. This results in a net accounts receivable balance approximating cash expected to be collected.
         a. Sales discounts are offered to encourage earlier payment by customers. Sales and related receivables can be recorded using either the gross method or the theoretically preferred net method.
         b. Trade discounts are applied sequentially and receivables are recorded net of any trade discount.
      2. Estimating Uncollectibles
         a. Direct write-off method: used for tax; is not GAAP.
         b. Allowance method is GAAP. The allowance for uncollectible accounts is a contra-asset. Percentage of sales method (income statement approach) determines bad debt expense as a percentage of sales or credit sales for the period. In the balance sheet approach (percent of ending A/R and aging method) the ending balance in the allowance account must equal an amount determined by an analysis of the A/R schedule.
         c. In the allowance method, writing off an account receivable involves debiting the allowance and crediting accounts receivable.
         d. When collecting an account previously written off, restore the account receivable and the allowance and then record the collection in the normal way.
      3. Factoring receivables can be done with or without recourse. With recourse means the transferor retains the risk of uncollectibility. Factoring without recourse is a sale of the receivable and the assignee assumes the risk of loss.
D. Notes Receivable

1. Discounting notes receivable involves transferring the note to a third party, usually for cash. This transfer can be with or without recourse. If done with recourse, a contingent liability is created for the transferor.

2. Determining the proceeds to be received requires deducting the banker’s discount (interest) from the maturity value of the note. The discount is calculated using maturity value, discount rate and time left to maturity.

II. INVENTORIES

A. All inventories owned by an entity should be included in the inventory account. FOB shipping terms can be used to establish when a purchase or sale has occurred. Sales with a right of return still count as sales if returns are estimable and other conditions are met. Consigned goods belong to the consignor.

B. Inventory account valuations should include all the costs necessary to make ready for intended use (sale).

1. Lower of cost or market (U.S. GAAP under LIFO and retail inventory methods) and lower of cost and net realizable value (all other U.S. GAAP methods and IFRS) are departures from cost basis caused by a decline in the inventory's utility.

2. Under the lower-of-cost-or-market method, when the inventory's replacement cost is lower than cost basis, a current period inventory write-down may be indicated based on the relationship between replacement cost and the market ceiling and floor.

3. Under the lower-of-cost-and-net-realizable value method, when an inventory's net realizable value (net sales price – costs to complete and dispose) is lower than cost basis, a current period inventory write-down should be recorded.

C. Perpetual and periodic inventory systems control how we account for purchases and sales of inventory.

1. Perpetual system records purchases with a debit to inventory. Periodic system records purchases with a debit to purchases.

2. Perpetual system records sales of inventory in two journal entries. The periodic system only records the receivable and revenue at time of sale. The inventory account is updated at the end of the period after taking a physical count.

D. Inventory methods under U.S. GAAP include first-in, first-out (FIFO), last-in, first-out (LIFO) and weighted average. IFRS does not permit the use of the LIFO method. These methods may apply to both periodic and perpetual systems. Because FIFO values inventory at most recent costs, it will generally result in a higher net income than other methods in a period of rising prices. Weighted average is called "moving average" in a perpetual inventory system.

E. The gross profit and retail inventory methods attempt to estimate ending inventory based on the historical gross profit or cost complement percentage.

F. Firm purchase commitments require current loss recognition if the contracted price exceeds the market price and if it is expected that losses will occur when the purchase is actually made.
III. FIXED ASSETS

A. Under U.S. GAAP, fixed assets are valued at historic cost to acquire and put into use with few exceptions. Donated fixed assets are recorded at fair value and a gain or revenue is recognized equal to that value.

B. Under IFRS, fixed assets are recorded upon acquisition at historic cost to acquire and put into use. Subsequently, fixed assets can be reported using either the cost model or the revaluation model:
   1. Cost Model—Fixed assets are reported on the balance sheet at historical cost less accumulated depreciation and impairment.
   2. Revaluation Model—Fixed assets are revalued to fair value at a specific point in time. The fixed assets are then reported on the balance sheet at fair value on the revaluation date less subsequent accumulated depreciation and subsequent impairment. When initially adjusting the fixed assets to fair value, revaluation losses are reported on the income statement and revaluation gains are reported in other comprehensive income as revaluation surplus. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required.

C. Additions or improvements increase the cost basis of the fixed assets.

D. Accounting for replacements depends on how the accounting records have been kept for the asset being replaced.

E. Ordinary repairs that maintain the asset should be expensed. Extraordinary repairs, such as overhauls or major replacements, should be capitalized.

F. Land should be recorded to reflect all the costs necessary to make the land ready for its intended use. Land improvements have finite lives and should be depreciated. Land is not depreciated.

G. Under IFRS, investment property is defined as land or buildings held to earn rental income or for capital appreciation. U.S. GAAP does not have an investment property classification. IFRS investment property is reported using one of two models:
   1. Cost Model—Investment property is reported on the balance sheet at historical cost less accumulated depreciation.
   2. Fair Value Model—Investment property is reported on the balance sheet at fair value and is not depreciated. Under the fair value model, the investment property should be revalued with regularity so that the carrying value does not differ materially from fair value. A gain or loss arising from a change in the fair value of investment property is recognized in earnings in the period in which it arises.

H. Constructed fixed assets should include capitalized interest on weighted average expenditures incurred during the construction period.

IV. DEPRECIABLE ASSETS AND DEPRECIATION

A. Under the component depreciation method, separate significant components of a fixed asset with different lives should be recorded and depreciated separately. The carrying amount of parts or components that are replaced should be derecognized. IFRS requires component depreciation.
B. The composite and group depreciation methods depreciate an entire class of assets over a single life. U.S. GAAP allows component depreciation and composite/group depreciation.

C. The straight-line, sum-of-the-years' digits and declining balance methods are the three major methods of depreciation. Under IFRS, the depreciation method used should match the expected pattern of fixed asset consumption. U.S. GAAP does not have the same requirement.

D. The units-of-production method is similar to the straight-line method except that the life is defined in number of units expected to be produced.

E. Depletion is similar to the units-of-production method except the former is applied to "wasting" assets. Restoration costs should be included in the depletion base.

V. FIXED ASSET IMPAIRMENT

A. Impairment under U.S. GAAP:
   Step 1: Test for Recoverability
   If the sum of undiscounted expected future cash flows is less than the carrying amount, an impairment loss needs to be recognized (go to Step 2).
   Step 2: Calculate Impairment Loss
   The impairment loss is the amount by which the carrying amount exceeds the fair value of the asset.

B. Impairment under IFRS:
   One Step Only: Impairment is the amount by which the carrying amount exceeds the higher of:
   1. Fair value – Costs to sell
   2. Value in use (present value of expected future cash flows)

C. If the impaired asset is held for use, the asset is written down to fair value and subsequent depreciation is based on that fair value. Under U.S. GAAP, if the fair value were to subsequently "rebound," no restoration is permitted. Restoration is permitted under IFRS.

D. If the asset is held for disposal, depreciation is discontinued. If the fair value were to partially recover prior to sale, a restoration is permitted under both IFRS and U.S. GAAP. This restoration result is similar to discontinued operations items in F1.