Select Balance Sheet Accounts

Uniform Certified Public Accountant (CPA) Examination

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Select Balance Sheet Accounts tests how each major asset, liability and equity account is measured, recorded and proved. Expect to compute a carrying amount, write the journal entry, roll a balance forward and reconcile a subledger to the general ledger, then decide whether a difference needs an adjustment.

You should be able to: Check yourself: can you reconcile a bank account, set a credit loss allowance, apply the right inventory write-down test, test an asset for impairment, carry an equity method investment, amortize a bond discount and record treasury stock reissues?

Every topic: the key point and the trap

Cash and bank reconciliations

Cash includes currency, demand deposits and checks received. Cash equivalents are short-term, highly liquid investments with an original maturity to the holder of three months or less (ASC 230 and ASC 305).

Trap: Recording a journal entry for a deposit in transit or an outstanding check. Those are timing items on the bank side only.

Trade receivables

Credit losses follow the current expected credit loss model: an allowance for losses expected over the life of the receivables, set up from the start using history, current conditions and supportable forecasts, often through an aging or loss-rate schedule (ASC 326-20).

Trap: Booking expense equal to the target allowance without looking at the balance already in the account.

Inventory

Cost methods: specific identification, FIFO, LIFO and weighted average (periodic) or moving average (perpetual). Cost includes purchase price, freight in and costs to bring goods to a saleable condition.

Trap: Applying the replacement-cost ceiling and floor test to FIFO or average cost inventory; that test is for LIFO and the retail method only.

Property, plant and equipment

Cost is every outlay needed to get the asset ready for use: price, freight, installation and testing; interest during construction of a qualifying asset is capitalized on average accumulated expenditures (ASC 835-20).

Trap: Comparing carrying amount with fair value in step one. The recoverability test uses undiscounted cash flows; fair value only measures the loss.

Investments

Equity securities with a readily determinable fair value are measured at fair value through net income. Those without one may use the measurement alternative: cost less impairment, adjusted for observable price changes in the same or a similar security (ASC 321).

Trap: Recording an equity-method investee's dividends as income. They are a return of investment and reduce the carrying amount.

Intangibles and software

Purchased intangibles are recorded at cost. In a business combination an intangible is recognized apart from goodwill if it arises from contractual or legal rights or is separable (ASC 805). Internal research and development is expensed (ASC 730).

Trap: Amortizing over the legal life when the expected useful life is shorter, or expensing application development costs that must be capitalized.

Payables and accruals

An asset retirement obligation is recognized at fair value (usually expected cash flows discounted at a credit-adjusted risk-free rate) when the legal obligation arises, with the same amount added to the asset. The liability accretes each year (accretion expense) and the added cost is depreciated (ASC 410-20).

Trap: Recognizing severance when management approves a plan. The liability waits until the plan is communicated to employees, and is spread over future service if employees must stay beyond the minimum retention period.

Notes and bonds payable

A change in debt terms is an extinguishment if the present value of the new cash flows differs by at least 10% from the present value of the remaining old cash flows, both at the original effective rate; the old debt is removed, the new recorded at fair value and a gain or loss recognized. Otherwise it is a modification and a new effective rate applies going forward (ASC 470-50).

Trap: Computing interest expense at the stated rate. The stated rate sets the cash; the market rate on the carrying amount sets the expense.

Equity transactions

Issuing stock: debit cash, credit common stock at par and additional paid-in capital for the excess; stock issued for noncash assets is recorded at the more clearly evident fair value.

Trap: Reporting a gain or loss on treasury stock in net income. Transactions in an entity's own shares go through equity only.

Key terms

Deposit in transit: Cash recorded in the books that the bank has not yet credited.

Outstanding check: A check written and recorded that has not yet cleared the bank.

Cash equivalent: A highly liquid investment with an original maturity of three months or less to the holder.

Current expected credit loss: The lifetime loss expected on financial assets at amortized cost, recognized from the start.

Factoring: Selling receivables to a third party, with or without recourse.

Secured borrowing: A transfer that fails sale accounting; the receivables stay and a liability is recorded.

Net realizable value: Estimated selling price less reasonably predictable costs of completion, disposal and transport.

FOB shipping point: Title passes to the buyer when goods leave the seller.

Consignment: Goods held by an agent for sale; they remain the owner's inventory.

Recoverability test: Comparing carrying amount with undiscounted future cash flows to decide if an asset is impaired.

Held for sale: A long-lived asset meeting all six criteria, carried at the lower of carrying amount and fair value less costs to sell.

Capitalized interest: Interest during construction added to the cost of a qualifying asset.

Held to maturity: Debt securities the holder has the positive intent and ability to hold to maturity, at amortized cost.

Available for sale: Debt securities at fair value, with unrealized changes in OCI apart from credit losses.

Significant influence: Power to take part in an investee's policy decisions, presumed at 20% to 50% of voting stock.

Measurement alternative: Cost less impairment, adjusted for observable price changes, for equity without a readily determinable fair value.

Indefinite-lived intangible: An intangible with no foreseeable limit on its useful life; tested for impairment, not amortized.

Cloud computing arrangement: Hosted software accessed over the internet; a service contract unless the customer can take the software.

Application development stage: Design, coding, installation and testing of internal-use software, when costs are capitalized.

Accretion expense: The yearly increase in a discounted obligation such as an asset retirement obligation.

Minimum retention period: The longest notice period required by law or contract before termination; service beyond it spreads the cost.

IBNR: Claims incurred but not reported, accrued under self-insurance.

Effective interest method: Interest at the market rate on the carrying amount, so the rate is constant over the life.

Extinguishment: Removal of a debt by payment or by a substantially different exchange, with a gain or loss.

Troubled debt restructuring: A concession granted to a debtor in financial difficulty.

Debt issuance costs: Costs to issue debt, deducted from its carrying amount and amortized as interest.

Treasury stock: An entity's own shares reacquired and not retired, shown as a reduction of equity.

Small stock dividend: A stock dividend under about 20% to 25% of shares, recorded at fair value.

Bonus method: Admitting a partner without recording goodwill; capital is reallocated among partners.

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