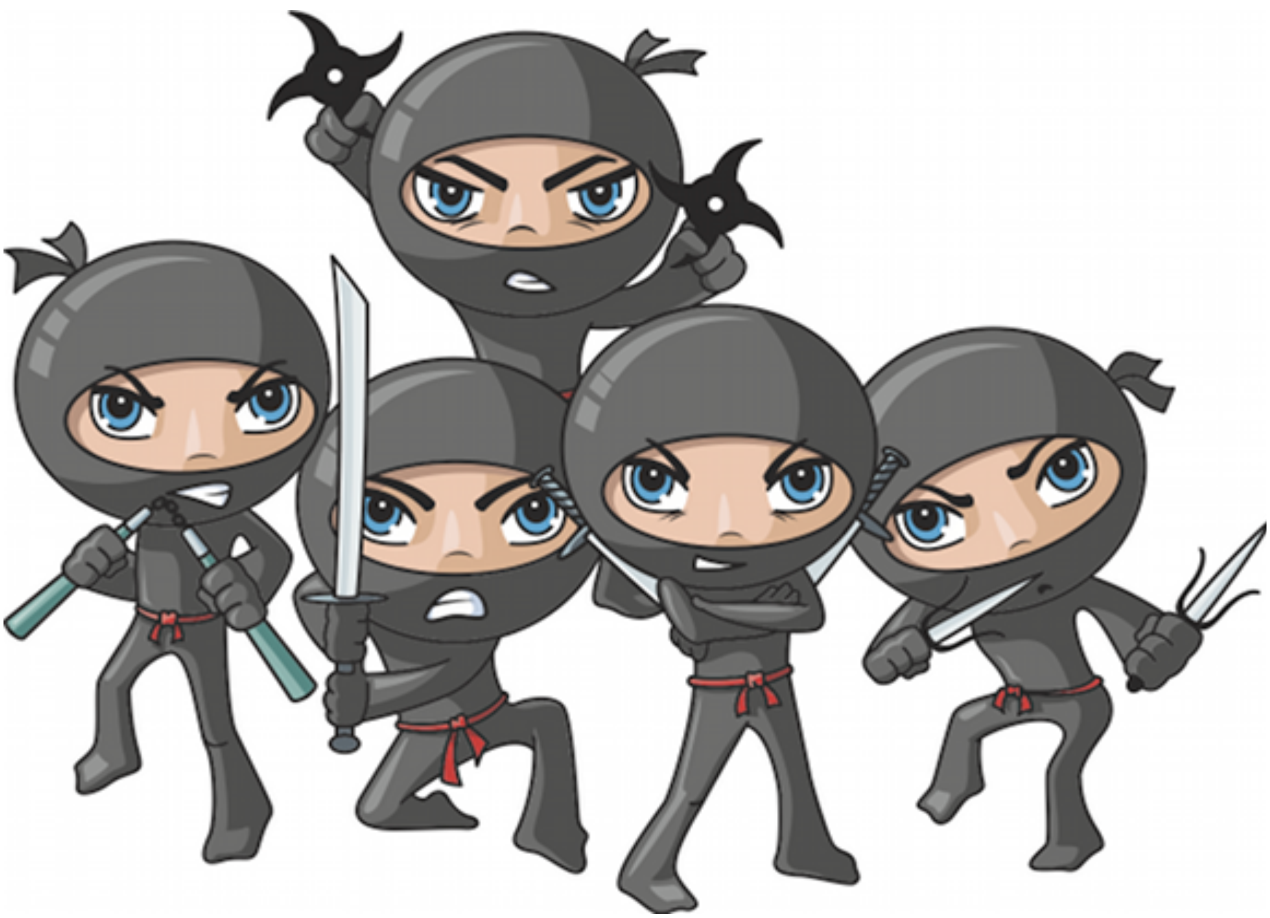
NINJA NOTES

Financial Accounting & Reporting
2024



Income Statement & Statement of Comprehensive Income

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Income Statement

Description

- Income Statement measures the financial performance of an enterprise from the aggregation of revenues, expenses, gains, and losses that are not items of other comprehensive income.

Format

- Single-Step Income Statement
  - Single-Step Income Statement is a simplified version of the traditional Income Statement, and it's called "Single-Step" because it uses only one subtraction to arrive at the Net Income.

Income Statement	
For the Year Ended December 31, Year 1	
Revenues & Income	XXX
Less: Expenses & Losses	XXX
Income (Loss) from Continuing Operations, Gross of Taxes	**XXX**
Less: Taxes (Current Taxes + Deferred Taxes)	(XXX)
Income (Loss) from Continuing Operations, Net of Taxes	**XXX**
Income (Loss) from Discontinued Operations, Net of Taxes	XXX
Net Income	**XXX**

- Multiple-Step Income Statement
  - Multiple-Step Income Statement, in contrast to the Single-Step Income Statement, provides a more detailed view of a company's financial performance by breaking down revenues and expenses into several categories.

Income Statement	
For the Year Ended December 31, Year 1	
Net Revenues	XXX
Less: Cost of Goods Sold	(XXX)
Gross Profit	**XXX**
Less: Operating Expenses	(XXX)
Operating Profit	**XXX**
Add: Non-Operating Gains & Revenues	XXX
Less: Non-Operating Losses & Expenses	(XXX)
Income (Loss) from Continuing Operations, Gross of Taxes	**XXX**
Less: Taxes (Current Taxes + Deferred Taxes)	(XXX)
Income (Loss) from Continuing Operations, Net of Taxes	**XXX**
Income (Loss) from Discontinued Operations, Net of Taxes	XXX
Net Income	**XXX**

Components of an Income Statement

- Net Revenue
  - Revenue Recognition Steps:
    - Step 1: Identify the contract(s) with a customer.
    - Step 2: Identify the performance obligations in the contract.
    - Step 3: Determine the transaction price (i.e., amount).
    - Step 4: Allocate the transaction price to the performance obligations in the contract.
    - Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.
  - Revenue Recognition Calculation

Sales	XXX
Less: Sales Return	(XXX)
Net Revenue	XXX

- Cost of Goods Sold

Opening Inventory	XXX
Add: Purchases	XXX
Less: Ending Inventory	(XXX)
Cost of Goods Sold	XXX

- Gross Profit

Revenues	XXX
Less: Cost of Goods Sold	(XXX)
Gross Profit	XXX

- Operating Expenses

Selling Expenses	Sales Staff Salaries & Commission, Freight Outward, Advertisements, Bad-Debt Expense & Depreciation on Sales Vehicles
General & Administrative Expense	Salaries, Rent, Insurance, Legal, Accounting Expenses & Depreciation on Office Equipment
Research & Development Expense	Research & Development Expense, Depreciation on Research & Development Equipment
Impairment Losses	Impairment on Tangible & Intangible Assets (For SEC Registrants)

- Operating Profit

Gross Profit	XXX
Less: Operating Expenses	(XXX)
Operating Profit	XXX

- Non-Operating Items

Investment Income & Expense	Interest Income, Interest Expense, Dividend Income, Unrealized Gain or Loss on Trading Securities, Gain or Loss on Foreign Currency Transactions.
Gain or Loss on Disposal	Gain or Loss on Sale of PPE & Intangible Assets
Unusual &/or Infrequent Items	Loss due to Natural disasters such as Fire, Hurricanes, etc.
Impairment Losses	Impairment on Tangible & Intangible Assets (For Non-SEC Registrants)

- Income (Loss) from Continuing Operations, Gross of Taxes

Operating Profit	XXX
Add/Less: Non-Operating Items	XXX/(XXX)
Income (Loss) from Continuing Operations, Gross of Taxes	XXX

- Income Taxes

Current Tax Liability	XXX
Add: Deferred Tax Liability	XXX
Less: Deferred Tax Asset	(XXX)
Income Tax Expense	XXX

- Income (Loss) from Continuing Operations, Net of Taxes

Income (Loss) from Continuing Operations, Gross of Taxes	XXX
Less: Income Tax Expense	(XXX)
Income (Loss) from Continuing Operations, Net of Taxes	XXX

- Income (Loss) from Discontinued Operations, Net of Taxes

Gain or Loss from Operations	XXX/(XXX)
Impairment Loss [CV – NRV]	(XXX)
Gain or Loss on Disposal [Proceeds – CV]	XXX/(XXX)
Income from Discontinued Operations, Gross of Tax	**XXX/(XXX)**
Add/Less: Tax Effects	XXX/(XXX)
Income from Discontinued Operations, Net of Tax	**XXX/(XXX)**

- Net Income

Income (Loss) from Continuing Operations, Net of Taxes	XXX
Income (Loss) from Discontinued Operations, Net of Taxes	XXX
Net Income	**XXX**

Statement of Comprehensive Income

Description

- Statement of Other Comprehensive Income (OCI) is a financial statement that displays items that are not included in the Net Income but affect the equity section of the Balance Sheet.

- Statement of Other Comprehensive Income (OCI) includes certain unrealized revenues, expenses, gains, and losses that are excluded from Net Income.

Format

Statement of Comprehensive Income	
For the Year Ended December 31, Year 1	
Net Income	**XXX**
Other Comprehensive Income	
Foreign Currency Translation Gain/Loss	XXX
Pension Adjustments	XXX
Unrealized Gain/Loss on Available-for-Sale Debt Securities	XXX
Gains/Loss on Derivatives designated as Cash Flow Hedges	XXX
Comprehensive Income	**XXX**

Components of Statement of Comprehensive Income

- Foreign Currency Translation Gain or Loss

- Pension Adjustments

- Unrealized Gains and Losses on Available-for-Sale (AFS) Debt Securities

- Gains and Losses on Derivative Instruments that are Designated as Cash Flow Hedges

Reclassification

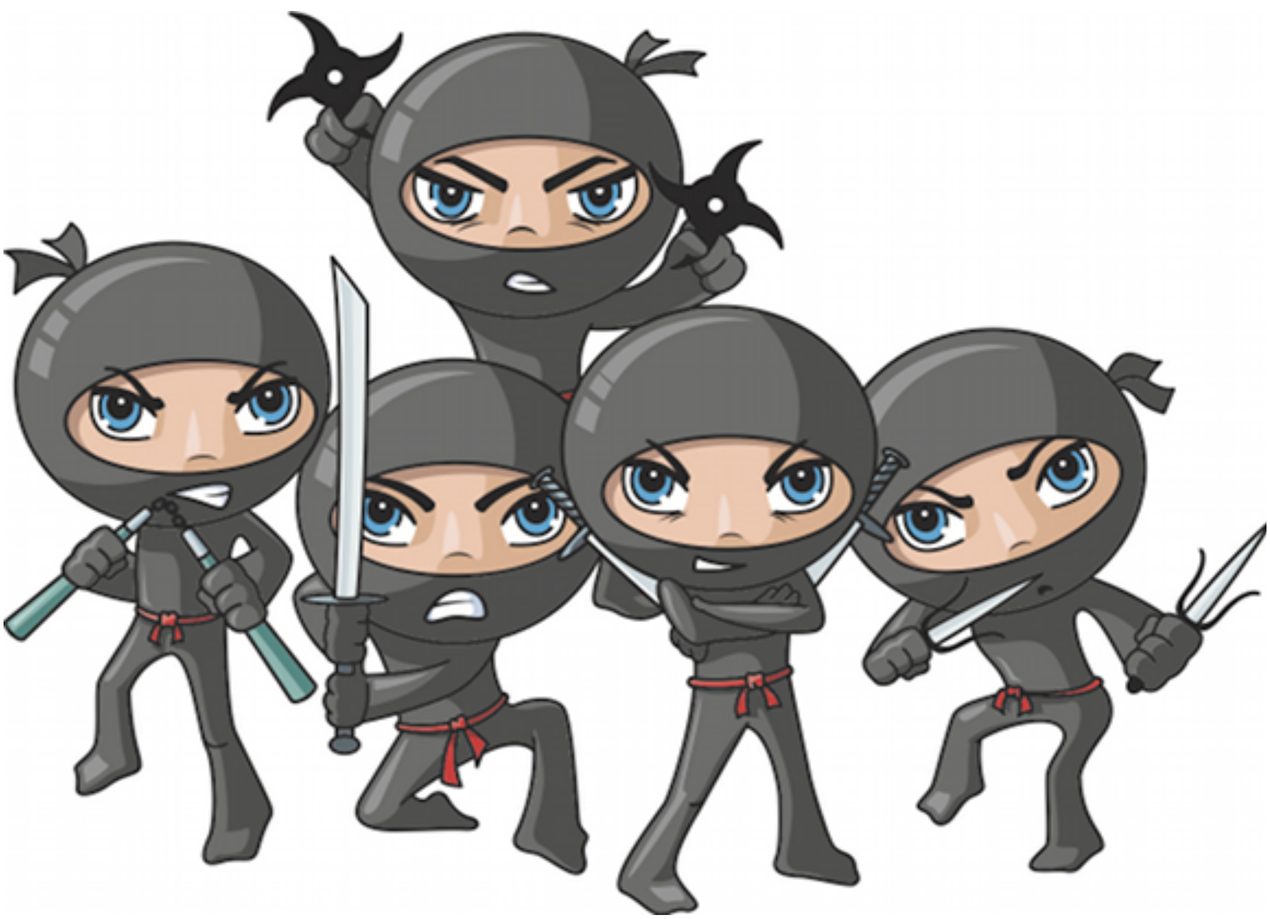
- Reclassification Adjustments move specific gains and losses from AOCI to Retained Earnings when those gains and losses are realized.

Presentation

- Combined Statement of Income and Comprehensive Income
    - Income Statement (or Statement of Profit or Loss) and the Statement of Comprehensive Income into a single statement
- Separate Statement of Income and Statement of Comprehensive Income
    - Income Statement and the Statement of Comprehensive Income as two separate but consecutive statements.

NINJA BOOK

Auditing & Attestation 2024



Engagement Acceptance

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Engagement Acceptance

Audit Stages

Pre-Engagement Acceptance Activities & Engagement Letter

I. Pre-Engagement Acceptance Activities
II. Engagement Letter
III. Continuing Engagements
IV. Client Request for a Change in the Terms of Engagement

Audit Stages

Audit Stages

Pre-Engagement Acceptance Activities	Before taking on a new client or continuing with an existing one, the audit firm must assess the client's integrity and the associated risks. This could involve background checks, evaluation of financial stability, and assessment of potential legal or reputation risks.
Engagement Letter	Once a client is accepted, the auditor and client sign an engagement letter, which is a formal agreement specifying the scope of the audit, responsibilities, timelines, and fees.
Audit Strategy & Planning	Audit Planning includes: • **Risk Assessment:** Auditors identify risks that might prevent financial statements from being fairly presented. • **Audit Strategy and Plan Development:** Based on the Risk Assessment, auditors devise a strategy detailing how the audit will be conducted. This includes selecting team members with the right expertise and determining the nature, timing, and extent of audit procedures. • **Materiality Determination:** Auditors decide on a threshold (materiality level) for misstatements. Misstatements below this threshold are not considered significant to financial statement users.
Internal Control Evaluation	Internal Control Evaluation includes: • **Understanding and Documenting Internal Controls:** Auditors gain an understanding of the client's internal control system and document this understanding, often through flowcharts or narratives. • **Control Testing:** Auditors test the operating effectiveness of controls. If controls are strong, auditors might reduce the substantive testing.

Substantive Procedures	Substantive Procedures includes: • **Analytical Procedures:** Analyzing plausible relationships among financial and non-financial data. • **Tests of Details:** Examining records or documents, whether internal or external, to support the amounts and disclosures in the financial statements.
Audit Completion	Audit Conclusion includes: • **Evaluation:** Evaluating misstatements identified during the audit and considering whether they individually or in aggregate affect the truthfulness of the financial statements. • **Forming an Opinion:** Forming an Opinion is a critical phase in the audit process where auditors analyze the collected audit evidence to form an Opinion on the Financial Statements.
Report Preparation and Communication	• **Drafting the Audit Report:** Based on the audit evidence gathered, the Auditor drafts the Audit report. • **Communication with Those Charged with Governance:** Discussing Significant Findings, Observations, and the Draft Report.
Post-Audit Responsibilities & Audit Quality Control	Post-Audit Responsibilities include: • **Archiving and Documentation Retention:** The auditor retains documentation for a specified period as per regulations. • **Post-Audit Meeting with Client:** Discussing the audit process, findings, and potential improvements for the next year. • **Audit Quality Control:** Some audits, especially for public companies, undergo a quality review by a separate team within the audit firm or by external reviewers.

Pre-Engagement Acceptance Activities & Engagement Letter

Pre-Engagement Acceptance Activities & Engagement Letter

I. Pre-Engagement Acceptance Activities

Pre-engagement acceptance activities are crucial steps that auditors undertake before formally agreeing to perform an audit for a potential client. These activities are necessary to ensure that the engagement will be carried

The following are key Pre-Engagement Acceptance Activities, an auditor would complete before deciding to accept a client:

Receive an Appointment

The beginning of any Auditing Relationship is the appointment of the auditor by the relevant authority. This ensures that the auditor has the necessary permissions and mandate to carry out their tasks.

Appointing Authority

An auditor is appointed by either an Issuer and Non-Issuer:

- **Issuer:** For Publicly Traded Companies (often referred to as issuers), the appointment of external auditors is typically done by the Audit Committee.

- **Non-Issuer:** For Private Companies or organizations that do not issue publicly traded securities, the appointment of auditors usually rests with "Those Charged with Governance," which might include the Board of Directors or similar governing bodies.

Timing of Appointment

The timing of an auditor’s appointment is crucial to ensure that the auditor has enough time to conduct a thorough and comprehensive audit without any limitations to the scope of their work.

Ideally an auditor should be appointed before year-end. Appointing an auditor well before the year-end allows them to get involved in the year-end close process, understand the company's operations, and conduct preliminary testing. This can be beneficial in understanding any unique risks or challenges that might need to be addressed during the audit.

If an auditor is appointed too late, particularly after the year-end, they might face challenges in accessing certain information, understanding transactions that took place earlier in the year, or ensuring appropriate testing of controls.

Assessment of Auditor's Capability

Before engaging in an audit, it's imperative for the auditing firm to assess whether they are capable of performing the audit in accordance with professional standards.

The auditor should assess the following:

- **Independence and Ethical Compliance:** An auditor must ensure they are independent and adhere to all relevant ethical rules of conduct. An auditor should:
  - Identify relationships or situations that could compromise independence.
  - Evaluate the significance of threats, considering both qualitative and quantitative factors.
  - Apply safeguards to eliminate the threats or reduce them to an acceptable level.
  - Regularly review and document their independence status, particularly when there are changes in the audit team, client, or scope of services

- **Resource Assessment:** The auditor should ascertain they have the necessary time and resources to finish the audit within the stipulated deadline. The auditor should:
  - Assess the size and complexity of the client's operations.
  - Estimate the number of hours required for various audit tasks.
  - Identify any specialized skills or knowledge needed for the audit.
  - Ensure that technological tools, such as auditing software, are up-to-date and relevant for the client's operations.

- **Personnel Competence:** It's essential to ensure that the audit team possesses the skills and personnel required to complete the engagement effectively. The auditor should:
  - Consider the qualifications of team members, such as certifications or special training.
  - Assess the team's collective experience with similar audits or industries.
  - Ensure continuous professional development through training and updating on new auditing standards or industry trends.
  - Rotate team members when necessary to provide fresh perspectives and prevent familiarity threats.

Assessment of the Client's Auditability

Understanding a client's auditability is a critical part of the pre-engagement process. An audit's success heavily depends on the auditee's financial reporting practices, transparency, and management's integrity.

The auditor should assess the following:

- **Management Integrity:** The auditor should evaluate the integrity and credibility of the management team.

- **Financial Reporting Framework**: The auditor should determine whether the Financial Reporting Framework utilized by the client is acceptable and aligned with standards.

- **Client's Responsibility Acknowledgment:** The client must acknowledge responsibility for Financial Statements and Internal Control.
  - **Financial Statements:** Management should acknowledge its responsibility for preparation and fair presentation of the financial statements according to the applicable financial reporting framework (AFRF).
  - **Internal Control:** Management should also acknowledge its responsibility concerning the design, implementation, and maintenance of internal controls.

- **Support for the Audit:** The client should guarantee that the auditor will have access to financial statement information, any additional information required, and unrestricted access to relevant personnel.

Communicate with the Predecessor Auditor

Communication with the predecessor auditor before accepting the engagement is a mandatory activity. This exchange ensures that the incoming auditor is well-informed about any past issues, disputes, or concerns that may be relevant for the current audit and can help the successor auditor determine the audit's scope, nature, and extent.

Communication with Predecessor Auditor would be as follows:

- **Management Authorization:** The auditor should seek management authorization to communicate with the Predecessor Auditor. If the client refuses, it would be considered a scope limitation and the auditor might decide to not accept the engagement. The predecessor auditor will have to respond as it is required by AICPA code of conduct.

- **Topics of Discussion:** The auditor should ask the predecessor auditor about the following before accepting the engagement

    - **Reasons for Change:** Before the new auditor assumes responsibility, it's important to understand why the predecessor auditor's engagement was terminated.
    - **Integrity of Management:** An auditor should ask the predecessor auditor about the credibility and reliability of the management. The predecessor might have insights into management's behavior, their willingness to comply with accounting standards, or any tendencies to manipulate financial statements.
    - **Past Audit Disagreements or Disputes:** The auditor should ask the predecessor auditor about past disputes the predecessor auditor had with the management.
    - **Communications with the Audit Committee:** The auditor should ask the predecessor auditor about the predecessor auditor’s communications with the Audit Committee on identified Fraud & Non-Compliance and Deficiencies & Weaknesses in Internal Control.
    - **Related Party and Unusual Transactions:** The auditor should ask the predecessor auditor about transactions involving related parties or those that are outside the ordinary course of business and can be used to mask financial statement misstatements or even fraud.

II. Engagement Letter

An Engagement Letter is an essential document in the auditing profession, acting as a contract between the auditor and the company being audited. It lays out the terms and conditions of the audit, the responsibilities of each party, and other critical details.

Purpose of the Engagement Letter

It's mandatory to have a written understanding in form of the Engagement Letter with the client, emphasizing the importance of documentation in the auditing process.

This understanding helps in avoiding ambiguities regarding the roles and responsibilities of both parties. It minimizes the risk that management might inappropriately expect the auditor to assume roles that are essentially management's duty.

Components of the Engagement Letter

- **Parties to Agreement:** Parties to Engagement Letter include:
  - **Auditor**
  - **Management**
  - **Those Charged with Governance:** For Non-Issuers, this is typically the Board of Directors (BOD). For Issuers, it can include both the Board of Directors (BOD) and the Audit Committee.

- **Objectives and Scope of Audit:** This includes the primary objectives of the audit and the depth or extent of the examination the auditor will undertake.

- **Management's Responsibilities:** Management is responsible for the following:
  - **Financial Statements and Internal Controls**: Management is responsible for preparing the financial statements and establishing and maintaining effective internal controls over financial reporting.
  - **Access:** Management must provide the auditor with unrestricted access to all information, financial records, and individuals that the auditor believes necessary for the audit.
  - **Written Representations:** Before concluding the audit, the auditor may request written representations from management to confirm certain aspects, such as the completeness of information provided.

- **The Auditor's Responsibilities:** The auditor is responsible for the following:
  - **Opinion:** The auditor's primary responsibility is to provide an opinion on the company's financial statements and, in the case of an integrated audit, on the effectiveness of internal controls over financial reporting.
  - **Communication:** If the auditor identifies any significant deficiencies or material weaknesses in the company's internal controls, they must communicate these to management and Those Charged with Governance.

- **Limitations of Audit:** An audit provides reasonable assurance, not absolute assurance. This means that there is always some risk that material misstatements may not be detected, due to inherent limitations like the use of sampling.

- **Form of the Audit Report:** The engagement letter may state that the audit report may not necessarily be unmodified. Depending on the findings, the auditor might issue a qualified opinion, an adverse opinion, or a disclaimer of opinion.

- **Fees and Other Arrangements:** The engagement letter will also outline the following:
  - **Fees Structure:** The engagement letter will outline the fee structure for the audit.
  - **Additional Services:** If there are additional services (e.g., tax consulting) to be provided, these will be specified.
  - **Involvement of Specialists and Internal Auditors:** Arrangements may be discussed regarding the involvement of specialists, internal auditors, and other staff of the entity in the audit process.
  - **Confidentiality:** Provisions concerning the sharing of audit documentation with third parties.

Sample Engagement Letter

To the appropriate representative of those charged with governance of ABC Company:

The Objective and Scope of the Audit

You have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.

The Responsibilities of the Auditor

We will conduct our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the inherent limitations of an audit together with the inherent limitations of internal control, an unavoidable risk that some material misstatements may not be detected exists, even though the audit is properly planned and performed in accordance with GAAS.

In making our risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.

The Responsibilities of Management and identification of the Applicable Financial Reporting Framework

Our audit will be conducted on the basis that management and, when appropriate, those charged with governance acknowledge and understand that they have responsibility

a. For the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America;
b. For the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
c. To provide us with
    i. access to all information of which [management] is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;
    ii. additional information that we may request from [management] for the purpose of the audit; and
    iii. unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [management and, when appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the audit.

Other Relevant Information

[Insert other information such as fee arrangements, billings, and other specific terms, as appropriate.]

Reporting

[Insert appropriate reference to the expected form and content of the auditor's report. Example follows:]

We will issue a written report upon completion of our audit of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified opinion will be expressed. Circumstances may arise in which it is necessary for us to modify our opinion, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement.

We also will issue a written report on [Insert appropriate reference to other auditor's reports expected to be issued] upon completion of our audit.

Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.
Acknowledged and agreed on behalf of ABC Company by

[Signed I Name and Title | Date]

III. Continuing Engagements

When an auditor has an ongoing relationship with a client, it is termed as a continuing engagement. Such engagements often involve recurring audits, reviews, or other assurance services. While the foundational terms of the engagement might remain consistent, each new period of audit could have varying factors or circumstances that might necessitate revisions to the original terms.

Continuing Engagements

Terms of Engagement: Unchanged

- If the terms of the audit engagement remain unchanged, it's a best practice to remind the client of the existing terms at the beginning of each audit cycle.
- This can be done either in writing or orally. If done orally, the auditor should carefully document the conversation to maintain a record.

Terms of Engagement: Changed

- If there are any changes to the original terms or if any additional services are to be provided, it's essential to document these in a written agreement.
- This could either be a revised engagement letter or an addendum to the original letter.

IV. Client Request for a Change in the Terms of Engagement

Auditors and clients might occasionally encounter situations where the client requests a change in the terms of the engagement or a lower level of assurance. The reasons for such requests can vary, and the auditor's response will depend on whether the request is reasonable or not.

Reasonable Request

A request is considered reasonable if the client may have misunderstood the nature or scope of the service initially agreed upon. This misunderstanding can be a legitimate reason for requesting a change. If the terms are changed due to such a misunderstanding, it's critical for both the auditor and the client to document the new terms. This is achieved through an updated engagement letter or a comparable written agreement.

In such cases, the subsequent report issued on the altered service should not make any reference to:

- The original audit engagement.
- Any audit procedures or tasks conducted during the original audit engagement.

Unreasonable Request

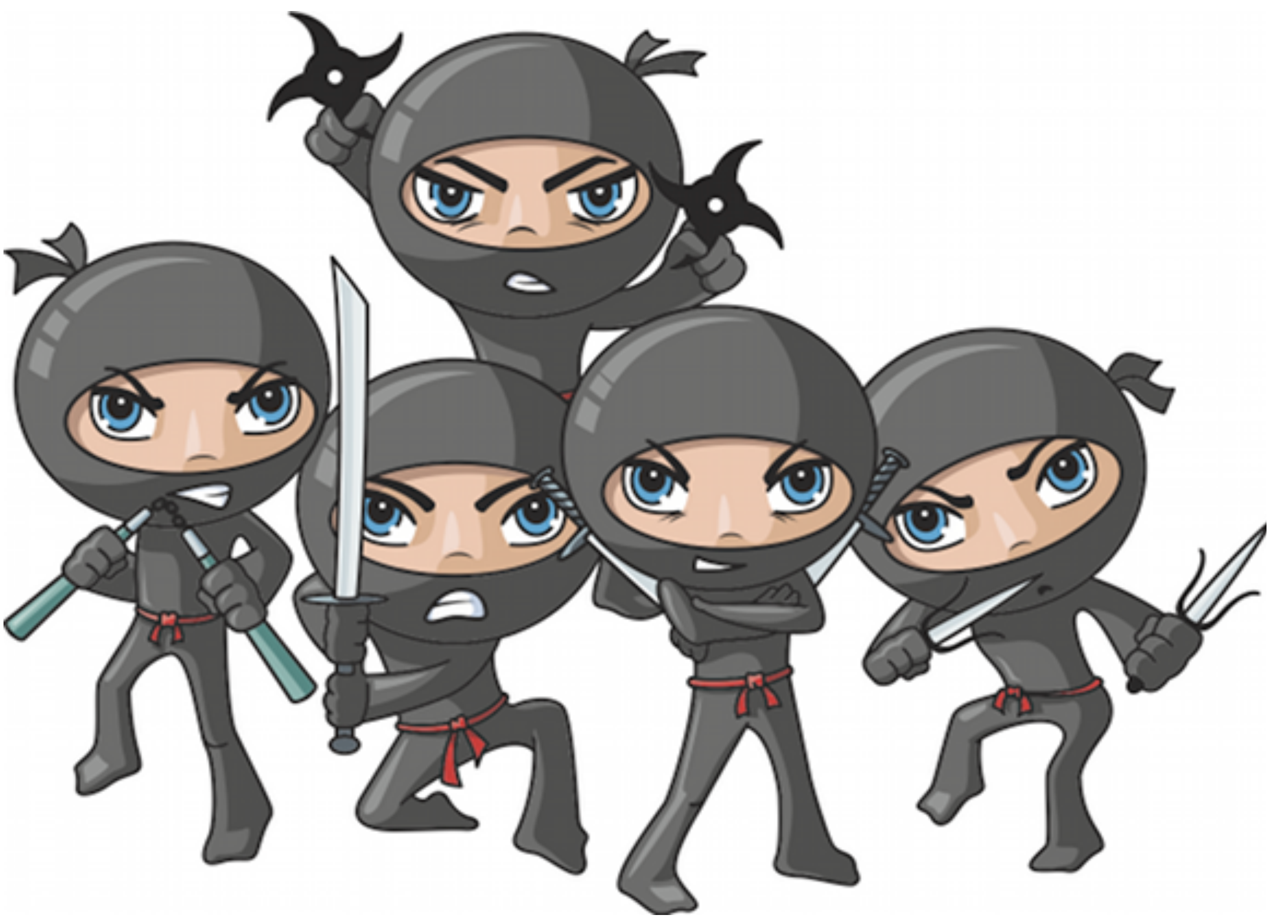
The auditor should decline any change in the engagement terms or a request to downgrade to a service with a lower level of assurance if there's no reasonable basis for the change. For instance, if the auditor faces challenges in validating receivables and the client pushes to change the engagement to a review (to avoid an adverse or qualified opinion), it's usually seen as an unreasonable request.

In the instance of an Unreasonable Request, the auditor should do the following:

- **Withdraw from the Engagement:** If the client's request lacks a reasonable basis and they don't allow the auditor to proceed with the original engagement, the auditor should consider withdrawing from the engagement.
- **Communication:** It's essential for the auditor to communicate the reasons for withdrawal and their concerns to those charged with governance. This communication often takes place with the audit committee or board of directors.
- **Obligation to Inform:** Depending on the regulatory environment and the nature of the client's operations, the auditor might also have an obligation to inform other stakeholders or regulatory bodies about their withdrawal and the reasons for it.

NINJA NOTES

Regulation 2024



S-Corporation Taxation

(July 1, 2024 – June 30, 2025 Exams)

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S-Corporation Taxation

S-Corporation: Overview

- Eligibility
    - Domestic Corporation
    - No More than 100 Shareholders
    - Eligible Shareholders
        - Shareholders must be Individuals, Estates or Trusts.
        - Corporations, Partnerships, or Non-Qualified Trusts cannot be shareholders.
        - Shareholders must be U.S. citizens or residents. Non-resident aliens cannot be shareholders.
    - Single Class of Stock
    - Ineligible Corporations
        - These include certain financial institutions, insurance companies, and domestic international sales corporations.
- Election
    - Unanimous Election
    - To elect to be an S Corporation, a corporation must submit Form 2553 "Election by a Small Business Corporation" signed by all the shareholders to the IRS.
    - To be considered an S Corporation for the current year, the election must be made either during the preceding year or by the 15th day of the third month of the current tax year.
- S-Corporation Taxable Year
    - General Rule
        - An S corporation is required to have a December 31st year-end or a fiscal year that matches the fiscal year of shareholders who own more than 50% of the corporation's stock.
    - Fiscal Year Exception
        - If a valid business purpose exists, an S corporation may ask for IRS approval to adopt a different fiscal year.

- Tax Accounting Basis: Cash & Accrual
    - Cash Basis
        - Cash Basis is allowed for S-Corporations that have average annual gross receipts of $30 Million or less (for 2024) during the preceding 3 Years.
    - Accrual Basis
        - Accrual Basis is required for S-Corporations that have average annual gross receipts of $30 Million or more (for 2024) during the preceding 3 Years.
- Overview of Form 1120-S
    - Form 1120-S: Filing Deadline
        - A S-Corporation must file Form 1120-S with the IRS on or before 2.5 months after the close of its tax year. For a calendar year (January to December) corporation, the return is due March 15.

Form 1120-S: Flow

S-Corporation	Individual

Form 1120-S
Revenues
<Business Expenses>
Ordinary Business Income

Schedule K (Total) (Only 1 Schedule K)	Schedule K-1 (Pro-rate For Each Shareholder) (Multiple prepared for each shareholder)	Form 1040
Ordinary Business Income →	% Ordinary Business Income →	Schedule E of Form 1040
Interest and Dividend Income →	% Interest and Dividend Income →	Schedule B of Form 1040
Rent and Royalties →	% Rent and Royalties →	Schedule E of Form 1040
Capital Gains →	% Capital Gains →	Schedule D of Form 1040
<Capital Losses> →	<% Capital Losses> →	Schedule D of Form 1040
<Charitable Contributions> →	<% Charitable Contributions> →	Schedule A of Form 1040
<Investment Interest Expense> →	<% Investment Interest Expense> →	Schedule A of Form 1040
<Tax Credit> →	<% Tax Credit> →	Form 1040
Income Reconciliation	**Income Reconciliation**	

Allocation of Income for Shares Held Less than A Year

- Calculate Total Annual Income
- Calculate Average Daily Income
  - Average Daily Income = $\frac{\text{Total Annual Income}}{365}$
- Calculate Average Daily Income Per Share
  - Average Daily Income Per Share = $\frac{\text{Average Daily Income}}{\text{No. of Shares}}$
- Allocate Income to Shareholder
  - Income Allocated to Shareholder = Average Daily Income Per Share x No. of Days

Fringe Benefits

Fringe Benefits to Less than 2% Shareholders	Deductible
Fringe Benefits to More than 2% Shareholders	Deductible to S-Corp only when included in Shareholder in Form W-2

Shareholder’s Basis in S-Corporation

- Shareholder’s Stock Basis in S-Corporation

Initial Basis	XXX
Add: Additional Contributions	XXX
Add: Non-Separately Stated Income	XXX
Add: Separately Stated Income	XXX
Add: Tax-Exempt Income	XXX
Less: Distributions	XXX
Less: Separately Stated Expenses	(XXX)
Less: Non-Separately Stated Expense	(XXX)
Less: Tax-Exempt Expense	(XXX)
Final Basis	**XXX**

- Shareholder’s Debt Basis in S-Corporation

Initial Debt Basis	XXX
Less: Repayments	XXX
Less: Separately Stated Expenses	(XXX)
Less: Non-Separately Stated Expense	(XXX)
Less: Tax-Exempt Expense	(XXX)
Final Basis	**XXX**

- Shareholder’s Tax Basis (At-Risk Basis) in S-Corporation

Tax Basis = Stock Basis + Debt Basis

- Shareholder’s At-Risk Basis in S-Corporation

Tax Basis = Stock Basis + Debt Basis − Non-Recourse Loans

- S-Corporation Shareholders Limitations on Loss Deduction

Tax Basis Limitation	Shareholders can only claim a loss to the extent of their Tax Basis in their S-Corporation which is the sum of Stock and Debt basis. If a shareholder's share of the S-Corporation's loss exceeds their tax basis, the excess loss is suspended and carried forward to future years.
At-Risk Basis	After applying the tax basis limitation, the at-risk rules further limit the amount of loss a shareholder can claim. If a shareholder's share of the S-Corporation's loss exceeds their at-risk basis, the excess loss is suspended and carried forward to future years.
Passive Activity Loss (PAL) Limitation	Passive Activity Loss is limited to Passive Activity Income. These rules generally apply if the shareholder does not materially participate in the S-Corporation's business.
Excess Business Loss Limitation	The Excess Business Loss Limitation will also apply. This rule limits the amount of net business losses a non-corporate taxpayer can use to offset other income. For 2024, the limit is $305,000 for single filers and $610,000 for married filing jointly. Any loss in excess of these amounts is treated as a net operating loss carryforward.

S-Corporation Earnings

- Accumulated Adjustment Account (AAA)

Opening Accumulated Adjustments Account (AAA)	XXX
Add: Non-Separately Stated Income Add: Separately Stated Income	XXX XXX
Less: Separately Stated Expenses Less: Non-Separately Stated Expense Less: Tax-Exempt Expense	(XXX) (XXX) (XXX)
Less: Distributions	(XXX)
Closing Accumulated Adjustments Account (AAA)	**XXX**

- Accumulated Earnings & Profits (AEP)

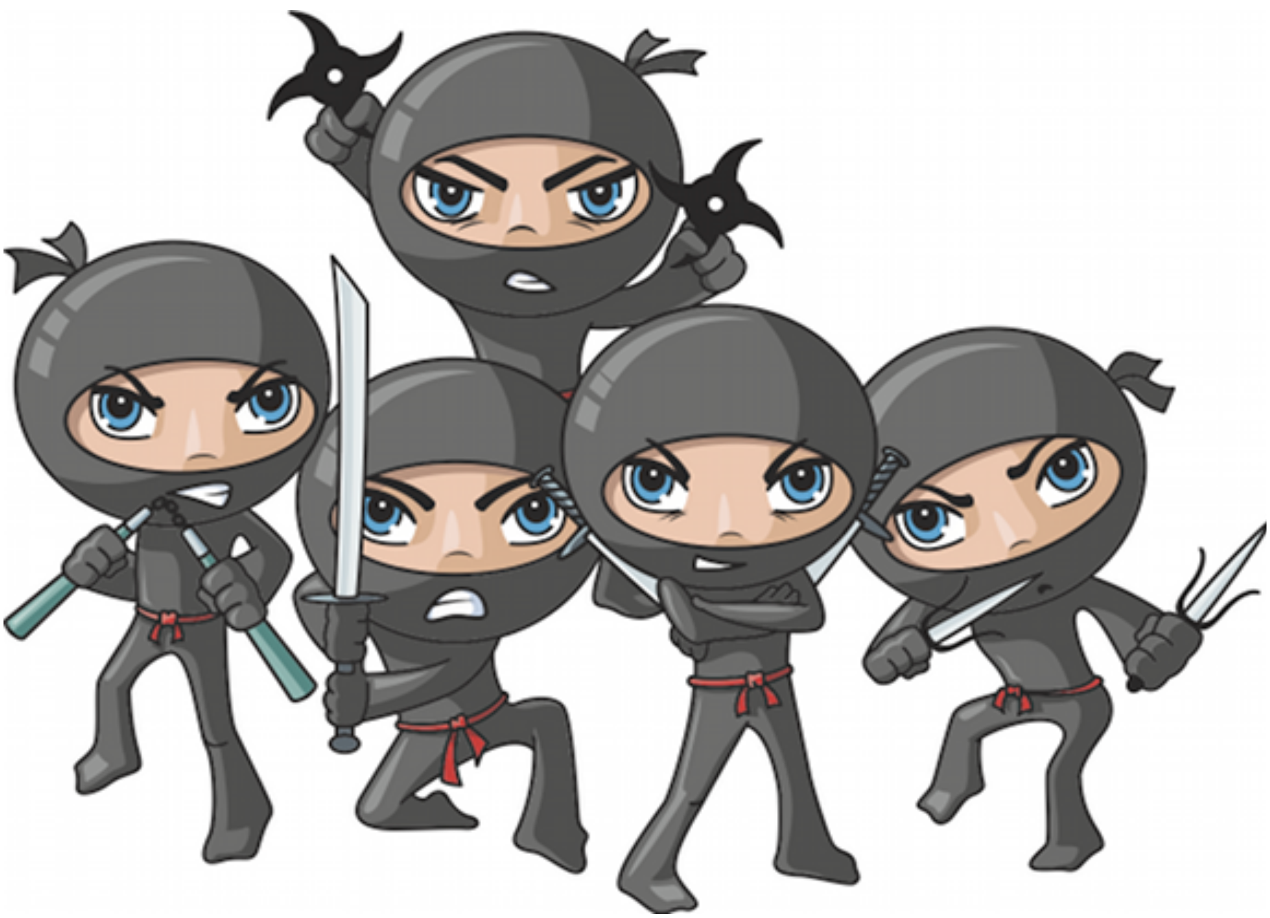
Opening Accumulated Earnings and Profit	**XXX**
Add/Less: Current Earnings and Profits	XXX / (XXX)
Less: Distributions • Cash Distributions: Amount Distributed • Property Distributions: (Higher of FMV or Basis) - Liability	(XXX)
Closing Accumulated Earnings and Profit	**XXX**

S-Corporation Termination

- S-Corporation Termination
    - Termination Reasons
        - Voluntary Revocation by Shareholders
            - Shareholders holding more than 50% of the corporation's shares can voluntarily terminate its S-Corporation status.
        - Failure to Meet Eligibility Requirements
            - Shareholder Limit Breached
            - Non-Resident Alien Shareholders
            - Ineligible Entity Shareholders
            - Multiple Classes of Stock
        - Termination Due to Excessive Passive Income
            - More than 25% of the S-Corp's gross receipts come from passive income for three consecutive years.
            - The corporation has Accumulated Earnings and Profits (AEP) from its time as a C-Corp at the end of each of these years.
    - Termination during the Middle of the Year
        - When the S-Corp status is terminated during a tax year, the corporation's income for the year is allocated between the S-Corp short year and the C-Corp short year.
    - Re-Election
        - Once the S-Corp status is terminated, the corporation generally can't re-elect S-Corp status for five years unless the IRS consents to an earlier re-election.

NINJA NOTES

Business Analysis & Reporting
2024



Strategic Planning & Budgeting

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Strategic Planning & Budgeting

Strategy

- Levels of Strategy
    - Corporate Strategy
        - The corporate strategy addresses issues facing the whole company.
        - The corporate strategy helps an organization decide the industries and businesses it should operate to maximize profitability.
    - Business Strategy
        - Business strategy involves decision-making processes to determine how a business segment operates and succeeds within its industry.
    - Functional Strategy
        - Every business division has different functions like marketing, operations, finance, sales, human resources, etc.
        - Functional-level strategy develops plans, objectives, and guidelines for each of these departments and functions, such as to maximize the effectiveness and efficiency of operations.
- Long-term Mission and Goals
    - Vision
        - The vision statement is the organization's objectives expressed in terms of contribution to society.
        - For example, Tesla's vision statement is: "To accelerate the world's transition to sustainable energy."
    - Mission
        - The mission statement refers to how an organization intends to create value for its stakeholders.
        - The mission statement is based on the vision statement and explains how an organization will achieve its vision.
        - For example, Tesla's mission statement is, "To create the most compelling car company of the 21st century by driving the world's transition to electric vehicles."

- Goals
  - Strategic Goals
    - Strategic goals are long-term in nature and deal with the entity's strategic policies.
    - For example, "Acquire 30% market share of United States automobile industry by 2030."
  - Tactical Goals
    - Tactical goals, on the other hand, are short-term in nature, and these ensure the achievement of strategic goals.
    - For example, "Increase production capacity by 20%."
- Objectives
  - Objectives are the plan of actions and should be specific, measurable, attainable, realistic, and timely (SMART).
  - For example, "Purchase additional machinery that would increase production capacity in the next 6-months."

Forecasting Techniques

- Regression Analysis
  - Regression analysis is a mathematical technique used to predict the value of the dependent variable based upon the value of the independent variable.
  - Regression Equation

Independent Variable

$$Y = a + bX$$

Dependent Variable

  - Multiple R
    - Coefficient of Correlation (R)
    - Measures the degree of linearity in the relationship between two variables
    - Between +1 and -1
      - Perfect Positive Correlation = 1
      - Perfect Negative Correlation = -1
      - No Correlation = 0
  - R-Square
    - Coefficient of Determination
    - Square of Coefficient of Correlation (R2)

        - Measures the effect of changes in one independent variable on another dependent variable
        - Between 1 and 0
            - Higher the value, Higher the explaining power of independent variable
    - Standard Error
        - Measures the accuracy and precision of predictions made using regression equation
    - T-Stat
        - Relationship of independent variable relative to dependent variable
            - Substantial and Long-Term Relationship
            - T-Stat of 2 or More is Significant, while 3 or More is Preferred
    - Advantages of Regression Analysis
        - Simplicity
        - Multiple Data Points
    - Disadvantages of Regression Analysis
        - Effect of Outliers
        - Assumption of Linearity
- Learning Curve Analysis
    - Graphic representation of relationship between productivity and experience
    - Useful for forecasting & budgeting labor costs
    - Learning Curve represents that people are much slower at performing a task for the first time, than they would be performing it for the 100th time
    - Cumulative Average-Time Learning Model
        - Learning curve applies at the average time taken to manufacture the product
        - Average time declines as production doubles
    - Advantages of Learning Curve Analysis
        - Accuracy

        - Planning
    - Disadvantages of Learning Curve Analysis
        - Constant Learning Rate
        - Relevance
- Expected Value Analysis
    - Prediction technique using the probability distribution
    - Allows Managers to make Decisions Resulting in Highest Expected Profit or Lowest Expected Loss
    - $Expected\ Value = \Sigma\, X \text{ x } P(X)$
    - Advantages of Expected Value Analysis
        - Multiple Scenarios
        - Simplicity
    - Disadvantages of Expected Value Analysis
        - Based on Estimates
        - Not the Most Likely Outcome
- Other Forecasting Tools
    - Sensitivity Analysis
        - Analysis of What-If Scenarios to Evaluate Possible Outcomes
        - Financial Estimate of Sensitivity of Scenarios to Change in Circumstances
        - Use of Probability Theory
            - Firms can Prepare for the Worst Case, Best Case &Most Likely Scenario
    - Time Series Analysis and Smoothing
        - Time Series Analysis
            - Trend Analysis
            - Measures Variables against Time

- Time is the Independent Variable

- Smoothing
  - Part of Time Series Analysis
  - Smoothening out random & uncertain fluctuations from the irregular components of a time series

- Decision Tree Analysis
  - Allows managers to choose outcome with highest expected payoff
  - Each Possible Outcomes = Branches of a Tree
  - Expected Payoff = Possible Payoff x Probability

- Monte-Carlo Simulations
  - Computer-Based Statistical Technique
  - Runs multiple simulations and generates values for a random variable at various probability distribution

Budgeting Methodologies

- A Budget may be defined as a plan for future operations expressed in dollars or units, or both.
- Master Budgets
  - A Master Budget provides a blueprint for the organization.
  - A Master Budget is divided into two parts (Operating Budgets and Financial Budgets), which include all of the following budgets from various functions:

Operating Budgets	Financial Budgets
Sales Budget	Cash Budget
Production Budget	Capital Budget
Direct Materials Budget	
Direct Labor Budget	
Overhead Budget	
Cost of Goods Sold Budget	
Selling and Administrative Expense Budget	

- Flexible Budgeting
    - Flexible Budgets
        - Based on Actual Level of Output
        - Provides for Better Comparison with Actual Costs
    - Preparation
        - Budgeted Rates x Actual Level of Activity
    - Example
        - Direct Materials Budget with 100,000 Units at a Standard Cost of $2 per Unit. Actual Production was 80,000 units at of $2.1 per unit

	Static Budget	Flexible	Actual
Units	100,000 units	80,000 units	80,000 units
Cost per Unit	$2	$2	$2.1
Total Direct Material Cost	$200,000	$160,000	$168,000

    - Benefits
        - Allows Estimation of Income at More than One Level of Output
        - As an Evaluation Tool allows for Fair Comparison
        - As an Evaluation Tool allows for Easy Variance Analysis
- Continuous (Rolling) Budgeting
    - Additional period added at the end of each budgeting period
        - Ensure sufficient number of periods planned
        - Constantly updates budget to the constantly changing operating environment
    - Benefits of Continuous Budgeting
        - Allows for Increased Alignment of Short-Term Goals with Long-Term Strategy
        - More relevant and updated budgets, increases the effectiveness of operations
        - Budgeting is broken into smaller, more manageable parts

- Zero-Based Budgeting
    - Starts from Scratch
    - Forward-Looking
    - Focused on Constant Cost Justification
    - Classifies Budget Requests on the Basis of Benefits Arising from Each activity
- Incremental Budgeting
    - Incremental changes made to prior period's budget
    - Changes are based on preceding year's results & future year's expectations
- Activity-Based Budgeting
    - Budgeting Technique
        - Budgets are prepared using activity-based costing
        - Overhead allocation using multiple cost drivers
    - Advantages
        - Increased Budget Accuracy
        - Judicious Consumption of Common Resources
    - Disadvantages
        - Expensive
        - Estimation Errors
- Project Budgeting
    - Budgeting for specific projects or assignments
    - Treated as a separate entity
    - All costs are tracked independently from rest of the organization
- Life-Cycle Budgeting
    - Life-Cycle Budgeting focuses on individual products and attempts to budget the costs of the product over the entire life cycle from research and development to customer support.

Operating Budget

- Sales Budget
  - The first step in the budgeting process (given the goals and policies of operation) is to forecast the level of sales for the budget period.
  - Sales budget is calculated: Forecasted Units x Forecasted Price
  - Example
    - Ninja Company, which is preparing the upcoming quarter budget (January-March), projected the following sales figures. Prepare the sales budget:

Month	Forecasted Units	Forecasted Sales Price ($)	Budgeted Sales ($)
December	10,000	$50	$500,000
January	12,000	$50	$600,000
February	15,000	$50	$750,000
March	18,000	$60	$1,080,000
April	20,000	$60	$1,200,000
May	22,000	$60	$1,320,000

Budgeted Sales (January, February & March)	$2,430,000

- Production Budget
    - The production budget calculates the number of units required to be produced to meet the expected sales targets, usually determined by the sales or marketing departments.

	Units
Opening Inventory	XXX
Add: Production	**XXX**
Less: Cost of Goods Sold	(XXX)
Ending Inventory	XXX

    - Example
        - Ninja Company's policy is to maintain finished goods inventory levels at 30% of the following month's budgeted sales units. Prepare the production budget:

Month	Budgeted Sales Units	Ending inventory (30% of Next Month's COGS)	Opening Inventory (Last Month's Ending Inventory)
December	10,000	3,600	-
January	12,000	4,500	3,600
February	15,000	5,400	4,500
March	18,000	6,000	5,400
April	20,000	6,600	6,000
May	22,000	0	6,600

	January	February	March	April
Opening Inventory	3,600	4,500	5,400	6,000
Add: Production (Balancing Figure)	12,900	15,900	18,600	20,600
Less: Units Sold	(12,000)	(15,000)	(18,000)	(20,000)
Ending Inventory	4,500	5,400	6,000	6,600

Budgeted Production (January, February & March)	47,400 units

- Direct Materials Budget
    - Direct Materials Usage Budget
        - Based on the production budget, the company first determines the units and cost of direct material required for production. This is done using the Direct Material Usage Budget.
        - Direct Materials Usage Budget = Units to be Produced x No. of pounds per Finished Good x Cost per Pound
        - Example
            - Ninja Company requires 2 pounds of direct material to produce 1 unit of finished goods. Each unit of direct material costs $5. Prepare a direct material usage budget.

	January	February	March	April
Production	12,900 units	15,900 units	18,600 units	20,600 units
No. of pounds per Finished Good	2	2	2	2
Pounds of Direct Material Required	25,800	31,800	37,200	41,200
Cost per Pound	$5	$5	$5	$5
Direct Material Cost	$129,000	$159,000	$186,000	$206,000

Budgeted Direct Materials Usage Cost (January, February & March)	$474,000

- Direct Materials Purchase Budget

  - Once the direct material requirement is established, the company determines the number of units of direct materials to be purchased.

	Units
Opening DM Inventory	XXX
Add: Purchase (a)	XXX
Less: Transfers to Production	(XXX)
Ending DM Inventory	XXX
Cost per Pound (b)	XXX
Direct Material Purchase Cost (a x b)	XXX

  - Example

    - Ninja Company's policy is to maintain direct material inventory levels at 20% of the following month's budgeted production units. Prepare the direct material purchase budget.

Month	Direct Material Required (Transfer to Production)	Ending inventory (20% of Next Month's Requirement)	Opening Inventory (Last Month's DM Ending Inventory)
January	25,800 pounds	6,360 pounds	5,160 pounds
February	31,800 pounds	7,440 pounds	6,360 pounds
March	37,200 pounds	8,240 pounds	7,440 pounds
April	41,200 pounds	-	8,240 pounds

	January	February	March
Opening DM Inventory	5,160	6,360	7,440
Add: Purchase (a)	27,000	32,880	38,000
Less: Transfers to Production	(25,800)	(31,800)	(37,200)
Ending DM Inventory	6,360	7,440	8,240
Cost per Pound (b)	$5	$5	$5
Direct Material Purchase Cost (a x b)	$135,000	$164,400	$190,000

Budgeted Direct Materials Purchase Cost (January, February & March)	$489,400

- Direct Labor Budget
    - The production budget will be used to prepare the direct labor budget.
    - This budget indicates the hours and cost of direct labor needed to meet production requirements.
    - Example
        - Ninja Company estimates that it takes 1 hour of labor to assemble a table. The labor rate is $8 per hour. Prepare the direct labor budget.

	January	February	March
Production	12,900 units	15,900 units	18,600 units
Hours Required per unit	1 Hour	1 Hour	1 Hour
Total Hours Required	12,900 Hours	15,900 Hours	18,600 Hours
Cost per Hour	$8	$8	$8
Direct Labor Cost	$103,200	$127,200	$148,800

Budgeted Direct Labor Cost (January, February & March)	$379,200

- Overhead Budget
    - Overhead Budget is usually divided into Fixed and Variable Costs.
    - Overheads can be allocated based on direct labor hours/machine hours or applied using activity-based costing.
    - Example
        - Ninja Company applies variable overheads based on direct labor hours at the rate of $3 per hour. The fixed overhead rate is $100,000 per month. Prepare the overhead budget.

	January	February	March
Variable Overhead			
Total Hours Required	12,900 Hours	15,900 Hours	18,600 Hours
Variable Overhead Rate per DL Hour	$3	$3	$3
Total Variable Overhead	$38,700	$47,700	$55,800
Fixed Overhead			
Total Fixed Overhead	$100,000	$100,000	$100,000
Total Overhead	$138,700	$147,700	$155,800

Budgeted Overhead (January, February & March)	$442,200

- Cost of Goods Sold Budget
  - Cost of Goods Sold Budget presents the total cost of producing the product sold for a period.

		$$
Opening Finished Goods Inventory (Given)		XXX
Add: Direct Materials (From Direct Material Usage Budget)		
Add: Direct Labor (From Direct Labor Budget)	XXX	
Add: Overheads (From Overheads Budget)	XXX	
Cost of Goods Manufactured		**XXX**
Cost of Goods Available for Sale		**XXX**
Less: Ending Finished Goods Inventory (Calculated)		(XXX)
Cost of Goods Sold		**XXX**

  - Example
    - Ninja Company's opening finished goods inventory was valued at $68,000. Prepare the cost of goods sold budget.

(January – March)		$$
Opening Finished Goods Inventory (Given)		$68,000
Add: Direct Materials (From Direct Material Usage Budget)	$474,000	
Add: Direct Labor (From Direct Labor Budget)	$379,200	
Add: Overheads (From Overheads Budget)	$442,200	
Cost of Goods Manufactured		**$1,295,400**
Cost of Goods Available for Sale		**$1,363,400**
Less: Ending Finished Goods Inventory (Calculated)		($162,000)
Cost of Goods Sold		**$1,201,400**

    - Ending finished goods inventory can be calculated as follows:
      - Total cost of goods manufactured = $1,295,400
      - Units manufactured (12,900 + 15,900 + 18,600) = 47,400 units
      - Cost per unit = $27
      - Ending finished goods inventory (6,000 units x $27) = $162,000

- Selling, General, and Administrative (SG&A) Expense Budget
  - Selling, General, and Administrative (SG&A) expense refers to period costs expensed in the period incurred.
  - These are non-manufacturing expenses that could be both fixed or variable.
  - Example
    - Prepare Ninja Company's SG&A Expense Budget.

	$$
Salaries	$200,000
Insurance	$200,000
Rent	$50,000
Advertising	$100,000
Total Selling, General & Administrative (SG&A) Expense	$550,000

- Pro Forma Income Statement
  - Budgeted Income Statement
  - Prepared Based on Sales Budget, Production Budget, Direct Materials Budget, Direct Labor Budget, Overhead Budget and Selling, General and Administrative Expenses Budget
  - Analyzed by top Management to Determine the Alignment with Objectives and Goals
  - Example

Sales (From Sales Budget)	$2,430,000
Less: Cost of Goods Sold (From Cost of Goods Sold Budget)	($1,201,400)
Gross Profit	$1,228,600
Less: SG&A Expense (From SG&A Budget)	($550,000)
Operating Profit	$678,600
Less: Taxes (30%)	($203,580)
Net Income	$475,020

- Cash Budget
  - Calculates the effect of all budgets on Cash
  - Prepared for the near future
  - Forecasts the Cash Outflows and Inflows of a Firm
  - Useful in the planning process for determining
    - Expected Sources and Uses of Funds
    - Availability of Funds for Investment Purposes
    - Need for External Financing
    - Availability of Funds for the Repayment of Debt
    - Availability of Funds for Distribution to Owners
  - Example
    - 30% is Cash sales, and Balance is Credit Sales. Cash Collection for Credit Sales is as follows:
      - 30% in Month of Sale
      - 40% in the month following the Month of Sale
      - 25% in the Second Month following the Month of Sale
      - 5% is uncollectible
    - 50% is Cash Purchases, and Balance is Credit Purchases. Cash Payment for Credit Purchase is as follows:
      - 60% in Month of Purchase
      - 40% in the month following the Month of Purchases
    - Operating Expenses, 80% of Operating Expenses are cash expenses and are paid in arrears.
    - Sales, Purchase and Operating Expenses information is given below:

	November	December	January	February	March
Sales	$100,000	$110,000	$120,000	$130,000	$140,000
Purchase	$40,000	$50,000	$60,000	$70,000	$80,000
Operating Expense	$30,000	$40,000	$50,000	$60,000	$70,000
Insurance					$30,000

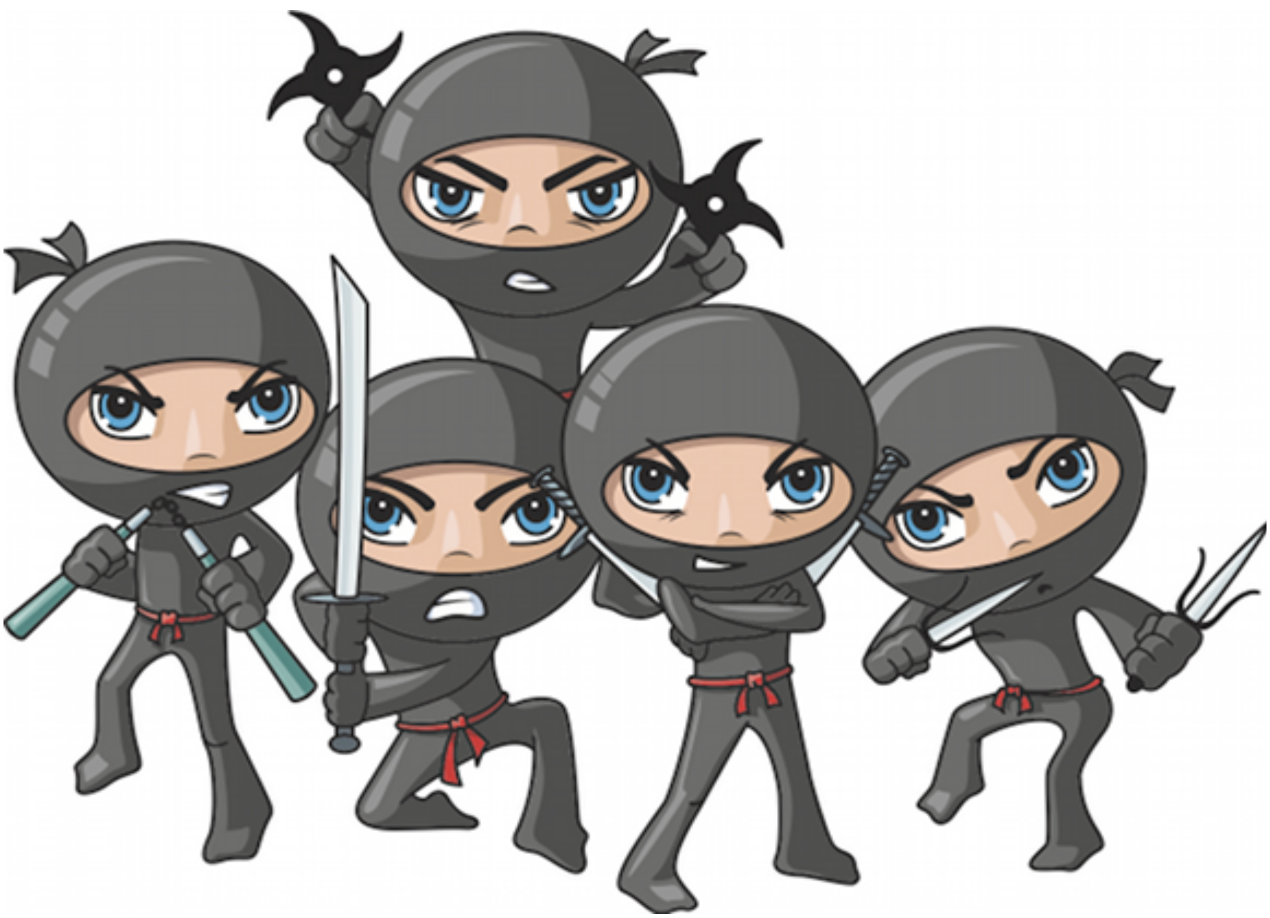
- Using this information prepare Cash Budget

	January	February	March
Total Sales	$120,000	$130,000	$140,000
Cash Sales (30% of Total Sales) (a)	$36,000	$39,000	$42,000
Credit Sales (70% of Total Sales)	$84,000	$91,000	$98,000
Cash Collection:			
30% in the Month of Sales (b)	$25,200	$27,300	$29,400
40% in Month following the Month of Sale (c)	$30,800	$33,600	$36,400
25% in the Second Month following the Month of Sale (d)	$17,500	$19,250	$21,000
Total Cash Receipts (A) = (a) + (b) + (c) + (d)	**$109,500**	**$119,150**	**$128,800**
Total Purchases	$60,000	$70,000	$80,000
Cash Purchases (50% of Total Purchases) (a)	$30,000	$35,000	$40,000
Credit Purchases (50% of Total Purchases)	$30,000	$35,000	$40,000
Cash Payment:			
60% in the Month of Purchase (b)	$18,000	$21,000	$24,000
40% in Month following the Month of Purchase (c)	$10,000	$12,000	$14,000
Operating Expense (d)	$32,000	$40,000	$48,000
Insurance (e)			$30,000
Total Cash Receipts (B) = (a) + (b) + (c) + (d) + (e)	$90,000	$108,000	$156,000
Cash Surplus (Deficit) (A) – (B)	$19,500	$11,150	($27,200)

- Pro Forma Balance Sheet
  - Calculates the estimated Financial Position of a company
  - Illustrates the effect of budgeting on components of Balance Sheet
- Pro Forma Statement of Cash Flows
  - Last Budget to be Prepared
  - Converts accrual-based Budgeted Income Statement and Balance Sheet into cash-based Information.

NINJA NOTES

Tax Compliance & Planning 2024



S-Corporation Taxation

(July 1, 2024 – June 30, 2025 Exams)

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S-Corporation Taxation

S-Corporation: Overview

- Eligibility
  - Domestic Corporation
  - No More than 100 Shareholders
  - Eligible Shareholders
    - Shareholders must be Individuals, Estates or Trusts.
    - Corporations, Partnerships, or Non-Qualified Trusts cannot be shareholders.
    - Shareholders must be U.S. citizens or residents. Nonresident aliens cannot be shareholders.
  - Single Class of Stock
  - Ineligible Corporations
    - These include certain financial institutions, insurance companies, and domestic international sales corporations.
- Election
  - Unanimous Election
  - To elect to be an S-Corporation, a corporation must submit Form 2553, "Election by a Small Business Corporation" signed by all the shareholders to the IRS.
  - To be considered an S-Corporation for the current year, the election must be made either during the preceding year or by the 15th day of the third month of the current tax year.
- S-Corporation Taxable Year
  - General Rule
    - An S-Corporation is required to have a December 31st year-end or a fiscal year that matches the fiscal year of shareholders who own more than 50% of the corporation's stock.
  - Fiscal Year Exception
    - If a valid business purpose exists, an S-Corporation may ask for IRS approval to adopt a different fiscal year.

- Tax Accounting Basis: Cash & Accrual
    - Cash Basis
        - Cash Basis is allowed for S-Corporations that have average annual gross receipts of $30 Million or less (for 2024) during the preceding 3 Years.
    - Accrual Basis
        - Accrual Basis is required for S-Corporations that have average annual gross receipts of $30 Million or more (for 2024) during the preceding 3 Years.
- Overview of Form 1120-S
    - Form 1120-S: Filing Deadline
        - A S-Corporation must file Form 1120-S with the IRS on or before 2.5 months after the close of its tax year. For a calendar year (January to December) corporation, the return is due March 15.

Formation of S-Corporations

Transactions	Gain / Loss for Shareholder	Shareholder's Basis in S-Corporation Stock	Gain / Loss for Corporation	Corporations Basis in Property
Issuance of Stock in Exchange for Cash				
Issuance of Stock in Exchange for Cash	• No Gain or Loss	• Value of Cash Contributed	• No Gain or Loss	• Value of Cash Contributed
Issuance of Stock in Exchange for Property				
Contributors of Cash and Property > 80% or More control	• Gain Realized = FMV – Basis • Gain Recognized = $0	• Basis of Property Contributed - Mortgage Debt Given Up	• No Gain or Loss	• Shareholder's Carryover Basis
Contributors of Cash and Property < 80% or More control	• Gain Realized & Recognized = FMV – Basis	• Basis of Property Contributed - Mortgage Debt Given Up + Gain Recognized	• No Gain or Loss	• Shareholder's Carryover Basis + Gain Recognized by the Shareholder
Boot is received by the shareholder along with stock	• Gain Realized = FMV – Basis • Gain Recognized = Lesser of Gain Realized or Boot Received	• Basis of Property Contributed - Mortgage Debt Given Up + Gain Recognized - Boot Received	• No Gain or Loss	• Shareholder's Carryover Basis + Gain Recognized by the Shareholder
Mortgage Debt Exceeds the Basis of Property	• Gain Realized & Recognized = Mortgage Debt – Basis	• Basis of Property Contributed - Mortgage Debt Given Up + Gain Recognized ($0)	• No Gain or Loss	• Shareholder's Carryover Basis + Gain Recognized by the Shareholder
Shareholder's Basis of Property > FMV of Property	• Loss Realized = Basis – FMV • Loss Recognized = $0	• Basis of Property Contributed - Mortgage Debt Given Up	• No Gain or Loss	• FMV of Property (Shareholder's Carryover Basis - Loss Realized by the Shareholder)
Issuance of Stock in Exchange for Services				
Issuance of Stock in Exchange for Services	• Ordinary Income = FMV of Stock Received	• FMV of Stock Received	• Value of Stock Issued for Services will be taken as Expense Deduction	• Corporation will have no basis in service since it was an expense

Form 1120-S: Flow

S-Corporation	Individual

Form 1120-S
Revenues
<Business Expenses>
Ordinary Business Income

Schedule K (Total) (Only 1 Schedule K)	Schedule K-1 (Pro-rate For Each Shareholder) (Multiple prepared for each shareholder)	Form 1040
Ordinary Business Income →	% Ordinary Business Income →	Schedule E of Form 1040
Interest and Dividend Income →	% Interest and Dividend Income →	Schedule B of Form 1040
Rent and Royalties →	% Rent and Royalties →	Schedule E of Form 1040
Capital Gains →	% Capital Gains →	Schedule D of Form 1040
<Capital Losses> →	<% Capital Losses> →	Schedule D of Form 1040
<Charitable Contributions> →	<% Charitable Contributions> →	Schedule A of Form 1040
<Investment Interest Expense> →	<% Investment Interest Expense> →	Schedule A of Form 1040
<Tax Credit> →	<% Tax Credit> →	Form 1040
Income Reconciliation	**Income Reconciliation**	

Allocation of Income for Shares Held Less than A Year

- Calculate Total Annual Income
- Calculate Average Daily Income
  - $\text{Average Daily Income} = \dfrac{\text{Total Annual Income}}{365}$
- Calculate Average Daily Income Per Share
  - $\text{Average Daily Income Per Share} = \dfrac{\text{Average Daily Income}}{\text{No. of Shares}}$
- Allocate Income to Shareholder
  - Income Allocated to Shareholder = Average Daily Income Per Share x No. of Days

Fringe Benefits

Fringe Benefits to Less than 2% Shareholders	Deductible
Fringe Benefits to More than 2% Shareholders	Deductible to S-Corp only when included in Shareholder in Form W-2

Shareholder's Basis in S-Corporation

- Shareholder's Stock Basis in S-Corporation

Initial Basis	XXX
Add: Additional Contributions	XXX
Add: Non-Separately Stated Income	XXX
Add: Separately Stated Income	XXX
Add: Tax-Exempt Income	XXX
Less: Distributions	XXX
Less: Separately Stated Expenses	(XXX)
Less: Non-Separately Stated Expense	(XXX)
Less: Tax-Exempt Expense	(XXX)
Final Basis	**XXX**

- Shareholder's Debt Basis in S-Corporation

Initial Debt Basis	XXX
Less: Repayments	XXX
Less: Separately Stated Expenses	(XXX)
Less: Non-Separately Stated Expense	(XXX)
Less: Tax-Exempt Expense	(XXX)
Final Basis	**XXX**

- Shareholder's Tax Basis (At-Risk Basis) in S-Corporation

Tax Basis = Stock Basis + Debt Basis

- Shareholder's At-Risk Basis in S-Corporation

Tax Basis = Stock Basis + Debt Basis − Non-Recourse Loans

- S-Corporation Shareholders Limitations on Loss Deduction

Tax Basis Limitation	Shareholders can only claim a loss to the extent of their Tax Basis in their S-Corporation which is the sum of Stock and Debt basis. If a shareholder's share of the S-Corporation's loss exceeds their tax basis, the excess loss is suspended and carried forward to future years.
At-Risk Basis	After applying the tax basis limitation, the at-risk rules further limit the amount of loss a shareholder can claim. If a shareholder's share of the S-Corporation's loss exceeds their at-risk basis, the excess loss is suspended and carried forward to future years.
Passive Activity Loss (PAL) Limitation	Passive Activity Loss is limited to Passive Activity Income. These rules generally apply if the shareholder does not materially participate in the S-Corporation's business.
Excess Business Loss Limitation	The Excess Business Loss Limitation will also apply. This rule limits the amount of net business losses a non-corporate taxpayer can use to offset other income. For 2024, the limit is $305,000 for single filers and $610,000 for married filing jointly. Any loss in excess of these amounts is treated as a net operating loss carryforward.

S-Corporation Earnings

- Accumulated Adjustment Account (AAA)

Opening Accumulated Adjustments Account (AAA)	XXX
Add: Non-Separately Stated Income Add: Separately Stated Income	XXX XXX
Less: Separately Stated Expenses Less: Non-Separately Stated Expense Less: Tax-Exempt Expense	(XXX) (XXX) (XXX)
Less: Distributions	(XXX)
Closing Accumulated Adjustments Account (AAA)	**XXX**

- Accumulated Earnings & Profits (AEP)

Opening Accumulated Earnings and Profit	**XXX**
Add/Less: Current Earnings and Profits	XXX / (XXX)
Less: Distributions • Cash Distributions: Amount Distributed • Property Distributions: (Higher of FMV or Basis) - Liability	(XXX)
Closing Accumulated Earnings and Profit	**XXX**

S-Corporation Non-Liquidating Distributions

- Distribution Amount

Type	Distribution Amount
Cash	Amount of Cash Received
Property	FMV of Property - Liability

- Treatment of Distribution

Property or Cash Distribution	
Up to Accumulated Adjustment Account (AAA)	• Non-Taxable • Reduces Shareholder’s Basis in s-Corporation Stock
Up to Accumulated Earnings and Profit (AEP) and in excess of Accumulated Adjustment Account (AAA)	• Taxable Dividend (Taxed at Ordinary Income Tax Rates). • No Impact on Basis
Beyond AAA and AEP but up to Basis	• Non-Taxable Return of Capital. • Reduces Shareholder’s Basis in C-Corporation Stock
Beyond Basis	• Taxable Capital Gain (Taxed at Capital Gain Tax Rates).

S-Corporation Liquidating Distribution

Transactions	Gain / Loss for Shareholder	Shareholder’s Basis in Property	Gain / Loss for Corporation
S-Corp Distributes Cash			
S-Corp Distributes Cash	• Gain or Loss = Cash Received – Basis in Stock	• Basis in Cash = Amount of Cash Received (FMV)	• No Gain or Loss
S-Corp Sells Property and Distributes Cash			
S-Corp Sells Property and Distributes Cash	• Gain or Loss = Cash Received – Basis in Stock	• Basis in Cash = Amount of Cash Received (FMV)	• Gain or Loss = Cash Received – Basis in Property
S-Corp Distributes Property			
Property is not Subject to Liability	• Gain or Loss = FMV of Property – Basis in Stock	• Basis in Property = Basis in C-Corporation Stock +/- Gain or Loss Recognized (FMV)	• Gain or Loss = FMV of Property – Basis in Property
Property is Subject to Liability and Liability < FMV	• Gain or Loss = (FMV of Property – Liability Assumed) – Basis in Stock	• Basis in Property = Basis in C-Corporation Stock +/- Gain or Loss Recognized + Liability Assumed (FMV)	• Gain or Loss = FMV of Property – Basis in Property
Property is Subject to Liability and Liability > FMV	• Loss = Basis in Stock	• Basis in Property = Basis in C-Corporation Stock +/- Gain or Loss Recognized + Liability Assumed (Liability)	• Gain = Liability – Basis in Property

S-Corporation Termination

- S-Corporation Termination
  - Termination Reasons
    - Voluntary Revocation by Shareholders
      - Shareholders holding more than 50% of the corporation's shares can voluntarily terminate its S-Corporation status.
    - Failure to Meet Eligibility Requirements
      - Shareholder Limit Breached
      - Non-Resident Alien Shareholders
      - Ineligible Entity Shareholders
      - Multiple Classes of Stock
    - Termination Due to Excessive Passive Income
      - More than 25% of the S-Corp's gross receipts come from passive income for three consecutive years.
      - The corporation has Accumulated Earnings and Profits (AEP) from its time as a C-Corp at the end of each of these years.
  - Termination during the Middle of the Year
    - When the S-Corp status is terminated during a tax year, the corporation's income for the year is allocated between the S-Corp short year and the C-Corp short year.
  - Re-Election
    - Once the S-Corp status is terminated, the corporation generally can't re-elect S-Corp status for five years, unless the IRS consents to an earlier re-election.

S-Corporation Level Taxes

- Built-In Gains Tax
  - The Built-In Gains tax applies if the S-Corporation sells or disposes of assets within 5 years after the conversion from C-Corporation status.
  - The tax is imposed on the "built-in gains" that were present at the time of the conversion, which are the unrealized gains on the corporation's assets, i.e., the excess of the Fair Market Value of the assets over their Tax Basis.
  - Calculation

FMV of Asset at S-Corporation Election Date
<Adjusted Tax Basis of Assets>
Built-In Gains
x 21% (Corporate Income Tax Rate)
Built-In Gains Tax

  - Exception
    - If the S-Corporation was never a C-Corporation.
    - If the sale or distribution of assets occurs more than five years after the S-Corporation election.
    - If the fair market value of the assets at the time of the S-Corp election was less than their basis or the assets were acquired after the S-Corp election.

- Tax on Passive Investment Income
  - S-Corporation will have to pay Tax on Passive Investment Income if the following two conditions are met:
    - S-Corporation has Accumulated Earnings & Profits (AEP) from its prior years as a C-Corporation.
    - S-Corporation generates passive investment income exceeding 25% of gross receipts.
  - Calculation

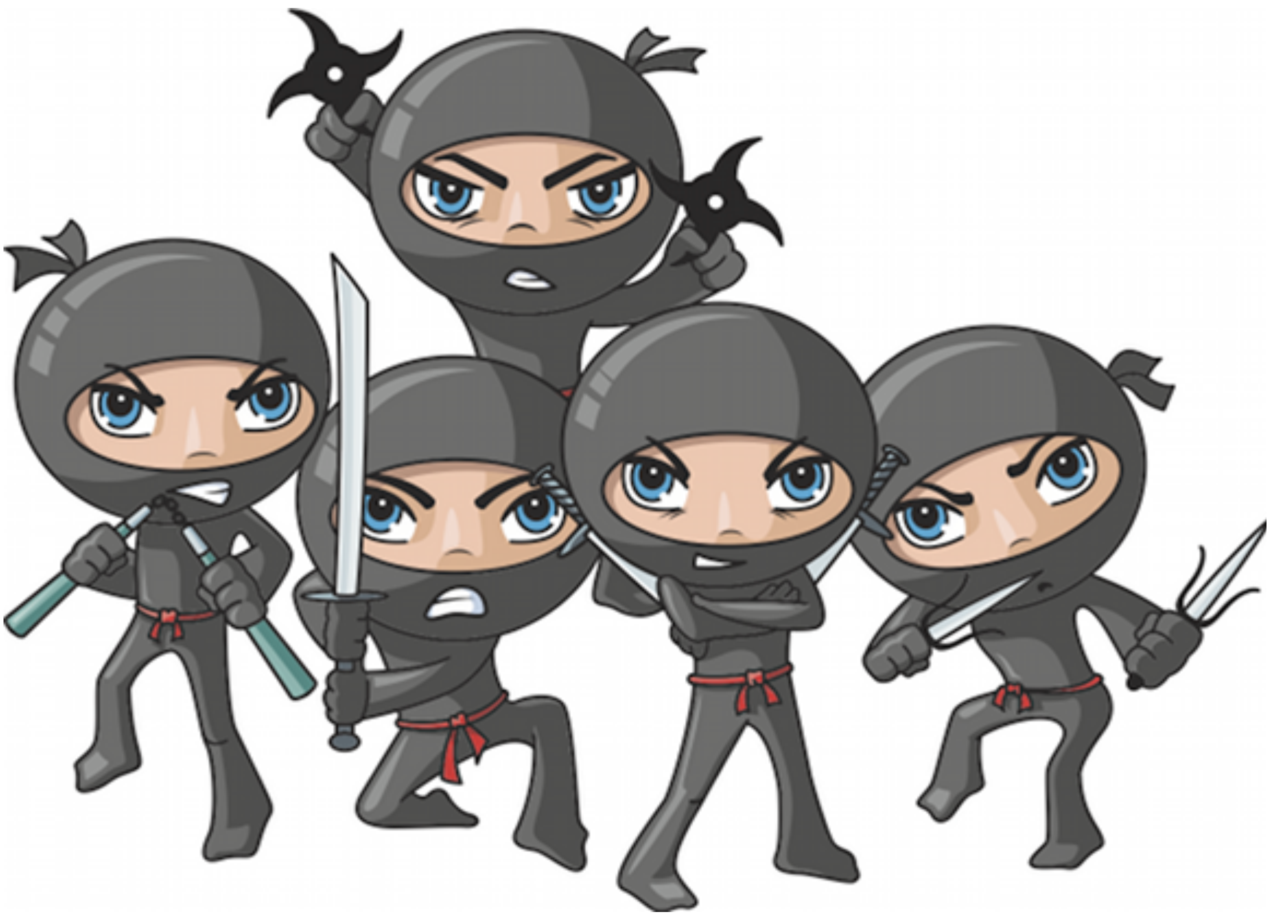
Excessive Passive Investment Income
x 21% (Corporate Income Tax Rate)
Passive Investment Income Tax

- LIFO Recapture Taxes
    - When a C-Corporation that uses the Last-In, First-Out (LIFO) method of inventory accounting elects to become an S-Corporation, it is required to recognize a "LIFO recapture amount."
    - Calculation

Inventory Value under FIFO – Inventory Value under LIFO
x 21% (Corporate Income Tax Rate)
LIFO Recapture Tax

NINJA NOTES

Information Systems & Control
2024



Emerging Technologies

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Emerging Technologies

Artificial Intelligence

- Artificial Intelligence (AI) is a field of computer science that focuses on the creation of intelligent machines that can mimic human perception, cognitive functions, and display a consciousness-like human mind
- Types of Artificial Intelligence (AI)
  - Weak AI
    - Weak AI, also known as Narrow AI, is designed to perform specific tasks and excel at them, such as Apple's Siri.
  - Strong AI
    - Strong AI, also known as Broad AI, is designed to possess cognitive abilities that are similar to that of a human, such as understanding natural language, recognizing faces, and making decisions.
- Applications of Artificial Intelligence (AI)
    - Self-Driving Cars
    - Image Recognition
    - Speech Recognition
    - Natural Language Processing
    - Robotics
    - Healthcare
    - Finance
    - Marketing
    - Climate Change
- Benefits of Implementing AI in Accounting Information Systems
    - Enhanced Automation
    - Improved Accuracy and Reduced Errors.
    - Advanced Data Analytics and Insights.

        - Fraud Detection and Prevention
        - Enhanced Decision-Making
        - Personalized Customer Experiences
        - Streamlined Regulatory Compliance
        - Increased Productivity
        - Scalability
        - Continuous Learning and Improvement

Machine Learning

- Machine Learning (ML) is a subfield of Artificial Intelligence (AI) where computers or machines have the ability to learn from data and improve their performance on a specific task without being explicitly programmed.
- Machine Learning algorithms can be divided into three main steps:
    - Infer/Predict
        - In the infer/predict step, the algorithm works on a given data set to draw an inference or make a prediction
    - Error
        - In the error step, the inference or prediction is compared to the desired outcome, and any errors are identified
    - Train/Learn
        - In the train/learn step, the algorithm learns from these errors and improves its performance over time
- Benefits of Implementing Machine Learning in Accounting Information Systems
    - Enhanced Automation
    - Improved Accuracy and Reduced Errors.
    - Advanced Data Analytics and Insights.
    - Fraud Detection and Prevention
    - Enhanced Decision-Making

    - Personalized Customer Experiences
    - Streamlined Regulatory Compliance
    - Increased Productivity
    - Scalability
    - Continuous Learning and Improvement

Robotic Process Automation

- Robotic Process Automation (RPA) is a technology that allows businesses to automate repetitive, routine tasks by mimicking the actions of a human user interacting with digital systems.
- This can include tasks such as data entry, form filling, and even complex workflows.
- Benefits of Implementing RPA in Accounting Information Systems
    - Speed and Accuracy
    - Reduced Manual Effort
    - Cost Savings
    - Enhanced Compliance
    - Improved Auditability and Transparency
    - Scalability
    - Real-Time Processing and Reporting
    - Integration with Other Systems

Blockchain

- Blockchain is a decentralized, digital ledger of transactions that is used to record and track transactions across a network of computers.
- One of the key features of blockchain technology is its ability to create trust between parties that don't know or trust each other.
- Blockchain Characteristics
    - Blockchain is a distributed ledger technology, meaning that it is spread across a network of computers, rather than being stored in a central location

- Blockchain is highly secure and resistant to tampering, as each block in the chain is connected to the previous block through cryptographic links called "hashes"
- Transactions on a blockchain are usually validated by a consensus mechanism, such as proof-of-work or proof-of-stake, where multiple users on the network validate the transaction
- Blockchain technology is often used for digital currencies, such as Bitcoin, but it can be applied to other areas such as supply chain management, voting systems, and many other industries
- The transparency and immutability of blockchain technology allow for increased trust and accountability in transactions

- Blockchain Working
  - Transactions are initiated by users, who send digital assets (such as cryptocurrencies) to specific addresses on the blockchain
  - These transactions are grouped together into blocks, which are then broadcast to the network for validation
  - Validating nodes, also known as "miners," use complex algorithms to verify the transactions and add the block to the blockchain
  - Once added, the block cannot be altered or deleted, creating a permanent and tamper-proof record of the transaction
  - The blockchain is maintained by a decentralized network of nodes, rather than a central authority, so there is no single point of failure

- Advantages of Blockchain
  - Increased security and immutability of records due to the decentralized and cryptographic nature of the technology
  - Reduced risk of fraud and corruption as transactions are transparent and tamper-proof
  - Improved efficiency and reduced intermediaries in various industries such as finance, supply chain management, and real estate
  - Enhanced privacy and protection of sensitive information as personal identification is often encrypted and not shared on the public ledger
  - Potential for smart contracts and decentralized applications that can automate processes and increase automation

- Disadvantages of Blockchain
    - Scalability issues as the number of users and transactions increases
    - Limited privacy and security concerns as information is publicly accessible
    - Limited interoperability between different blockchain systems
    - Energy consumption for maintaining and verifying the network can be high
    - Potential for illegal activities such as money laundering and fraud due to the anonymity of transactions
    - Limited adoption and understanding of the technology among individuals and businesses.
- Smart Contracts
    - Blockchain technology also enables the creation of smart contracts, which are self-executing contracts with the terms of the agreement directly written into lines of code.
- Blockchain and Financial Reporting
    - Enhanced Data Accuracy and Integrity
    - Real-Time Reporting
    - Increased Transparency and Traceability
    - Automation with Smart Contracts
    - Intercompany Transactions
    - Secure Data Sharing
    - Simplified Consolidation
    - Reduced Audit Complexity
    - Regulatory Compliance

Cryptocurrency

- Cryptocurrency is a digital or virtual currency that uses cryptography for security.
- It operates independently of a central bank and is decentralized, meaning it is not controlled by any government or institution.
- Bitcoin, the first and most well-known cryptocurrency, was created in 2009.