Quick Study® BUSINESS

ACCOUNTING 1

ACCOUNTING BASICS

CONCEPTS, PRINCIPLES & BASIS

A. Entity Concept
- An organization stands apart from other organizations as a separate economic unit

B. Going Concern Concept
- Entity will continue to operate long enough to recover cost of its assets

C. Time Period Concept
- Report information at regular intervals

D. Reliability Principle
- Accounting records must be based on the most reliable (verifiable by an independent observer) data available

E. Cost Principle
- Assets/services acquired are recorded at actual, historical cost

F. Revenue Principle
1. Establishes when to record revenue, usually when earned
2. Revenue is earned when the business has completed rendering services to the customer
3. Amount to record is equal to cash value of services or goods

G. Matching Principle
- Expenses matched against revenues in same accounting period

H. The Accounting Period
1. Usually one year ending December 31
2. Fiscal year ends on any other date of the year

I. Cash Basis Accounting
- Impact of events not recognized until cash is paid or received

J. Accrual Basis Accounting
1. Impact of events recognized as they occur
2. Transactions are recorded even when cash not received or paid
3. Required by GAAP

K. Stable Monetary Unit
- Basis for ignoring inflation

THE ACCOUNTING EQUATION

ASSETS=LIABILITIES+OWNERS' EQUITY

A. Assets
1. Economic resources expected to benefit company in future
   a. **Cash:** Money, certificates of deposit, and checks
   b. **Accounts Receivable:** Oral or implied promise, usually arise from sales made to customers, no promissory note exists
   c. **Notes Receivable:** Promissory notes
   d. **Inventory:** Merchandise the entity holds or manufactures to sell
   e. **Land:** Property the business owns and uses in operations
   f. **Building:** Cost of an office, warehouse, garage, etc.
   g. **Equipment, furniture, & fixtures:** Accounts that record the cost of office equipment and store equipment

B. Liabilities: Economic obligations, debts
1. **Accounts Payable:** Oral or implied promise to pay debts which arise from credit purchases
2. **Notes Payable:** Amounts the company must pay as a result of signing a promissory note for goods or services.
3. **Taxes payable:** Wages payable, Salary payable

C. Owners' Equity: Claims held by owners, divided into two main categories
1. **Contributed or Paid in Capital** (Amounts invested in corporation by owners)
2. **Retained Earnings** (Income earned from operations)
   a. **Expenses:** Decreases in retained earnings resulting from operations
   b. **Revenues:** Increases in retained earnings resulting from operations
   c. **Dividends:** Distributions of assets to shareholders decreases R.E.

BALANCE SHEET ACCOUNTS

ASSETS		LIABILITIES & OWNERS EQUITY	
DEBIT	CREDIT	DEBIT	CREDIT
Increases	Decreases	Decreases	Increases

JOURNAL ENTRY

Date	Description	Ref.	Debit	Credit
2003 May 1	**Supplies** (*asset increase*)		**1500.65**	
	Accounts Payable (*liability increase*)			**1500.65**
	Supplies purchased on account			

Supplies = Asset		Accounts Payable = Liability	
DEBIT	CREDIT	DEBIT	CREDIT
1500.65			**1500.65**

FINANCIAL STATEMENTS - FORMAL REPORTS OF AN ENTITY

BALANCE SHEET

A. Assets balanced with the sum of liabilities and owner's equity
B. As of a specific date
C. Also called **Statement of Financial Position**

COMPANY BALANCE SHEET
December 31, 20xx

ASSETS			
Current Assets:			
Cash		$58,280	
Accounts receivable	50,300		
Allowance for doubtful accounts	3,100	47,200	
Notes receivable		8,000	
Merchandise inventory		58,000	
Prepaid insurance		6,000	
Total current assets			$177,480
Long-Term Assets:			
Plant and Equipment			
Land		$60,000	
Building	110,000		
Accum. depr	65,000	45,000	
Delivery truck #1	13,000		
Accum. depr	4,200	8,800	
Total long-term assets			113,800
TOTAL ASSETS			**$291,280**
LIABILITIES			
Current Liabilities:			
Accounts payable		$30,000	
Notes payable		4,000	
Salaries payable		2,000	
Unearned rent		900	
Total current liabilities			36,900
Long-term liabilities:			
Note payable			30,000
TOTAL LIABILITIES			**$66,900**
STOCKHOLDERS' EQUITY			
Paid-in capital:			
Common stock, $10 par (10,000 authorized and issued)	$100,000		
Paid-in excess of par	62,080		
Total paid-in capital		162,080	
Retained Earnings		62,300	
TOTAL STOCKHOLDERS' EQUITY			**$224,380**
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY			**$291,280**

RETAINED EARNINGS STATEMENT

A. Summary of changes in retained earnings during specific period;
B. Begins with retained earnings balance at beginning of period;
1. Add net income or subtract net loss;
2. Deduct dividends;
3. End with new retained earnings balance.

INCOME STATEMENT

A. Summary of revenues and expenses of an entity
B. For a period in time
C. Also called Statement of Earnings or Statement of Operations
D. Reports net income or net loss of the period

COMPANY INCOME STATEMENT
For Year Ended December 31, 20xx

Sales			$600,000	
Less:				
Sales returns and allowances		9,500		
Sales discounts		4,500	14,000	
Net sales				$586,000
Cost of goods sold:				
Beginning Inventory, Jan.1, 20xx			$55,000	
Purchases		490,000		
Less:				
Purchase returns and allowances	8,800			
Purchase discounts	4,900	13,700		
Net Purchases		$476,300		
Add: Transportation in		8,300		
Cost of merchandise purchased			484,600	
Merchandise available for sale			539,600	
Less ending inventory Dec. 31, 20xx			58,000	
Cost of merchandise sold				$481,600
GROSS PROFIT ON SALES				**$104,400**
Operating Expenses:				
Selling Expenses:				
Sales salaries expense		$39,100		
Advertising expense		1,200		
Bad debt expense		1,000		
Depreciation expense-delivery truck		800		
Miscellaneous expenses		200		
Total selling expenses			$42,300	
Administrative expenses:				
Office salaries expense		$13,000		
Rent expense		10,000		
Depreciation expense-Building		900		
Insurance expense		1,900		
Office supplies expense		340		
Miscellaneous expenses		180		
Total admin. expenses			26,320	
Total operating expenses				$68,620
Income from operations				$35,780
Other Income:				
Interest income		$800		
Rental income		10,000	10,800	
Other expenses:				
Interest expense			$600	10,200
NET INCOME				**$45,980**
Average number of shares outstanding		10,000		
Earnings per share		$4.60		

COMPANY RETAINED EARNINGS STATEMENT

For Year Ended December 31, 20xx

Retained earnings, January 1, 20xx		$16,320
Net income for year	45,980	
Less dividends	-0-	
Increase in Retained earnings		45,980
Retained earnings, December 31, 20xx		$62,300

STATEMENT OF CASH FLOWS

A. Reports cash flows from Operating, Investing & Financing activities

COMPANY
Statement of Cash Flows
For Year Ended December 31, 20xx

Cash flows from operating activities:			
Net income per income statement		$45,980	
Add: Depreciation	1,700		
Allowance for doubtful accounts	1,000	2,700	48,680
Deduct: Increase in inventory	3,000		
Increase in prepaid expenses	1,000		
Decrease in accounts payable	2,500	6,500	
Net cash flow from operating activities			$42,180
Cash flows from investing activities:			
Cash received from investments sold............................		$10,000	
Less: cash paid for store equipment		3,000	
Net cash flow from investing activities................			$7,000
Cash flows from financing activities:			
Cash paid for dividends			-0-
Increase in cash			$49,180
Cash at the beginning of the year			9,100
Cash at the end of the year			$58,280

THE ACCOUNTING CYCLE

A. Procedures: Process which produces financial statements
1. Steps in the cycle
   a. Open ledger accounts;
   b. Journalize transactions;
   c. Post to the ledger;
   d. Calculate unadjusted balances;
   e. Develop trial balance on a work sheet;
   f. Journalize and post adjusting entries;
      i. Match revenues and expenses to period earned and incurred
      ii. Correct measurement of period's income
      iii. Bring related asset and liability accounts up-to-date
   g. Prepare financial statements;
   h. Journalize and post closing entries;
   i. Prepare post closing trial balance.

B. Five categories of adjusting entries
1. **Prepaid expenses:** Expire or are used up in next period
2. **Accrued expenses:** Expenses incurred but not yet paid
3. **Depreciation:** Systematically spreads cost of assets over periods
4. **Accrued revenue:** Revenue earned, but cash not yet received
5. **Unearned revenue:** Revenue not earned by business but cash already received

C. The adjusting process
1. Purpose is to measure income correctly
   • Accrual method
2. Each entry affects one income statement account (revenue or expense)
3. Each entry also affects one balance sheet account (asset or liability)

TRANSACTIONS

A. Transaction
1. Any event that affects financial position and is recorded
2. Affects both sides of the accounting equation

B. Examples
1. X invests $10,000 in company Y
2. Company Y buys land worth $5,000 for future office
3. Company Y buys $2,000 worth of office supplies on account
4. Company Y receives $3,000 due from its customers
5. Company Y pays $2,000 of its accounts payable

ASSETS=LIABILITIES=STOCKHOLDER'S EQUITY

	ASSETS		= LIABILITIES	+ S.E.
1.	+10,000	cash		+10,000 S.E.
2.	-5,000	cash		
	+5,000	land		
3.	+2,000	office sup.	+2,000 accounts payable	
4.	+3,000	cash		
	-3,000	accounts receivable		
5.	-2,000	cash	-2.000 accounts payable	

C. Transactions recorded in accounts called "T accounts"
1. **Assets accounts**
   a. Increases recorded on the left side (Debit side)
   b. Decreases recorded on the right side (Credit side)
2. **Liability accounts**
   a. Increases recorded on the right side (Credit side)
   b. Decreases recorded on the left side (Debit side)
3. **Owners' Equity accounts**
   a. Increases recorded on the right side (Credit side)
   b. Decreases recorded on the left side (Debit side)

OPERATING CYCLE OF A MERCHANDISE BUSINESS

A. Purchase merchandise inventory
1. Items bought for resale to customers
2. When INVOICE is received:
   a. DEBIT - Purchases
      i. Record Net of any quantity discounts
      ii. Purchase Discounts - computed on Net Purchases, is a contra account to Purchases (CREDIT balance), recorded when cash is paid early
   b. CREDIT - Accounts Payable

B. Purchase Returns and Allowances
1. Contra account to purchases (CREDIT balance)
2. When merchandise is returned or received damaged:
   • DEBIT - A/P & CREDIT - Purchase Returns and Allowances

C. Net Purchases
   • Purchases minus discounts minus returns and allowances

D. Transportation Cost
1. Free on Board (FOB) governs legal title to goods shipped
   a. **FOB** Shipping
      i. Title passes when inventory placed on the carrier
      ii. BUYER pays shipping cost
   b. **FOB** Destination
      i. Title passes when inventory received by the buyer
      ii. SELLER pays shipping cost
2. Entry: DEBIT-Freight In & CREDIT-cash or accounts payable

E. Sale of Inventory
1. Journal Entry: DEBIT - Cash or accounts receivable & CREDIT - Sales revenue
2. Sales Discounts, Returns and Allowances, Contra accounts to Sales Revenue
   • When company receives a returned good: DEBIT - Sales Returns and Allowances & CREDIT - A/R
3. Net Sales = Sales Revenue minus Sales Discounts minus Sales Returns and Allowances

F. Cost of Goods Sold (COGS): Beginning Inventory + Freight In + Purchases = Goods available for sale - Ending Inventory

INVENTORY SYSTEMS

A. Periodic
1. Inventory entries made only at the end of the period
2. Must calculate COGS
   a. On the Balance Sheet, show ending inventory
   b. On the Income Statement, show calculation of COGS
3. Detailed inventory accounts are not kept up-to-date
4. Journal Entries
   a. To record purchase: DEBIT-Purchases;CREDIT-A/P#
   b. To record sales: DEBIT-A/R & CREDIT-sales revenue
   c. To Close the books, end of period
      i. DEBIT - Inc. Sumry for Beg. Inv. bal. & CREDIT - Inv. (Beg. Bal)
      ii. DEBIT - Inv. (Ending Bal.) & CREDIT - Inc. Sumry (Ending Bal)

B. Perpetual
1. Continuous record of inventory on hand is maintained
2. Inventory on hand is computed daily
3. Physical count only to check on perpetual records
4. On the Balance Sheet, show Inventory
5. On the Income Statement, Sales Revenue - COGS = Gross Margin
6. Journal Entries
   a. To record purchase: DEBIT-Inventory; CREDIT-A/P
   b. To record sales: DEBIT- A/R & CREDIT-Sales Revenue & DEBIT- COGS; CREDIT- Inventory

CORPORATE CHARACTERISTICS

A. Separate legal entity
1. Formed under state law
2. Granted a charter from the state
3. Similar to an artificial person
4. Ownership interests are divided into shares of stock

B. Continuity of life: Corporations live regardless of changes in ownership of stock

C. No mutual agency: Stockholder cannot commit the corporation to a contract, unless he does so in his capacity as an officer

D. Limited liability: The most a stockholder can lose is the amount of money he invested

E. Separation of ownership and management: The stockholders own the business and elect Board of Directors (BOD) who appoint corporate officers who manage the company

TYPES OF BUSINESS ORGANIZATIONS

A. Proprietorship:
1. Usually small retail businesses or individual professional businesses such as attorneys and accountants
2. Single owner with personal liability

B. Partnership:
1. More than one owner
2. Each owner is a partner with personal liability

C. Corporations:
1. Owned by stockholders with limited liability
2. Dominant form of business in the United States

RECORDING TRANSACTIONS

A. Transactions are first recorded in journals
1. Record date
2. Record the account title
3. Record the posting references
4. Record the debits and the credits in separate columns

B. After the amounts are journalized, they are then posted to the ledger.
1. Record date
2. Any special notations
3. Journal reference
4. Record the debits and credits: A trial balance can now be taken, which lists all accounts and their up-to-date balance

ACCOUNTING IN BUSINESS

A. Users of accounting information
1. **Individuals:** To manage bank accounts, evaluate job prospects, make investments, and decisions
2. **Businesses:** To set goals, evaluate company progress, decide which building or equipment to purchase
3. **Investors and Creditors:** To decide whether to start a new venture, evaluate what income they expect on their investment, analyze a company's financial statements

B. The accounting profession
1. **Public accountants**
   a. Serve the general public
   b. Work includes auditing, income tax planning and preparation, management consulting
   c. 10% of all accountants
2. **Private accountants**
   a. Work for a single business
   b. Examples are restaurants, charitable organizations, educational institutions, and government agencies

C. Accounting organizations and designations
1. **American Institute of Certified Public Accountants (AICPA)**
   a. The national professional organization of CPAs
   b. Prepares and grades the CPA exam
   c. Publishes monthly journal, the Journal of Accountancy
   d. Each state has its own AICPA chapter
2. **Financial Accounting Standards Board (FASB)**
   a. Formulates generally accepted accounting principles (GAAP)
   b. These principles establish accounting guidelines
3. **Institute of Management Accountants (IMA)**
   a. Formerly the National Association of Accountants (NAA). Focus on the practice of management accounting
4. **Certifications**
   a. Certified Public Accountant (CPA)
   b. Certified Management Accountant (CMA)
   c. Certified Internal Auditor (CIA)

ASSETS

CASH

A. First item on the Balance Sheet

B. Cash Short and Over
1. Difference between actual cash receipts and recorded total
2. If sales revenue exceeds cash receipts DEBIT Cash Short and Over (Misc. Expense)
3. If cash receipts exceed sales revenue CREDIT Cash Short and Over (Other Revenue)

C. Petty Cash
1. Small amount of cash on hand to pay for minor expenses
2. Designate custodian
3. Keep specific amount in fund (Imprest system)
4. All fund disbursements are supported by petty cash ticket-replenish fund through normal cash disbursement procedures

ACCOUNTS RECEIVABLE & NOTES RECEIVABLE

A. Receivables
1. Claims against businesses and individuals
2. Accounts Receivable: Amounts that customers owe
   a. Sometimes called Trade Receivables
   b. Current assets
3. **Notes Receivable:** Promise in writing by debtor
   a. If due in one year-Current Asset
   b. If due in more than one year-Long Term Asset

B. Uncollectible Accounts (Bad Debts)
1. **Allowance Method** *(based on Accounts Receivable)*
   a. Allowance for Accounts-contra asset account related to A/R
   b. A/R - Allowance for Uncollectible Accounts=Net Realizable Value of A/R
   c. Writing off accounts-entry has no effect on net income; no expense is incurred
      i. DEBIT- Allowance for Uncollectible Accounts
      ii. CREDIT- Accounts Receivable
   d. Recovery of an account previously written off
      i. Reinstate Account; DEBIT-Accounts Receivable
      ii. CREDIT- Allowance for Uncollectible Accounts
      iii. Record cash collected, DEBIT Cash
      iv. CREDIT-Accounts Receivable
2. **Direct Write-Off Method:** Written off when determined uncollectible
   a. DEBIT- Uncollectible Account Expense
   b. CREDIT- A/R

C. Notes Receivable
1. More formal than accounts receivable
2. Promissory note (written promise to pay)
   a. DEBIT - Note Receivable-Name
   b. CREDIT - Cash or A/R
   c. When collected
   • DEBIT - Cash; CREDIT - Notes Receivable & CREDIT - Interest Revenue
3. Discounting a Note (Selling note before maturity)
   a. Computing discount
      i. Calculate Maturity Value (Principal + Interest)
      ii. Calculate the bank discount period (Total period of the note minus days the note is held prior to discounting)
      iii. Calculate bank discount (Maturity Value x discount rate x discount period)
      iv. Calculate the proceeds (Maturity Value minus discount)
   b. Prepare the Journal Entry
      i. DEBIT- Cash; CREDIT-Notes Receivable
      ii. CREDIT- Interest Revenue or
      iii. DEBIT- Interest Expense (If proceeds< principal amount)

LONG-LIVED ASSETS AND RELATED EXPENSES

A. Assets-future economic benefits
1. **Plant Assets:** tangible, land, buildings, equipment
2. **Intangible Assets:** benefit from rights, patents, copyrights, trademarks, goodwill
3. **Cost of Assets**
   a. Purchase price
   b. Brokerage commissions
   c. Survey fees
   d. Legal fees
   e. Back property taxes
   f. Sales and other taxes
   g. Transportation charges and insurance while in transit
   h. Installation cost

B. Group or Basket Purchase: Allocate cost by relative fair market value

COST ALLOCATION METHODS

A. Natural resources expensed through depletion
1. Depletion expense is portion of natural resource that is used up during period
2. Calculated same as units of production
3. Record Depletion Expense and Accumulated depletion

B. Intangible assets expensed through amortization
1. Straight-line over a maximum period of 40 years
2. Amortization is written off directly against the asset

INVENTORY

A. Costing Methods
1. **Specific Unit**
   a. Used when inventory can be individually identified, i.e., autos, jewels, real estate
   b. Cost of inventory is specific cost of particular unit
2. **Weighted-average-flow of cost over periods**
   a. Based on weighted-average cost of inventory during the period
   b. Average cost = Cost of goods available for sale/number of units available
   c. Ending inv. and COGS = number of units x weighted average cost per unit

<u>Average Cost Method</u> **(weighted average cost method)**

Ending inventory is made up of the weighted average unit costs.

$ 24,000/1800 = $13.33 per unit
250 units x $13.33 = $3,333

Example:

Jan. 1	Beginning Inventory..	100 units at	$10 =	$1,000
Feb. 6	Purchases................	400 units at	12 =	4,800
May 9	Purchases................	200 units at	13 =	2,600
July 3	Purchases................	300 units at	13 =	3,900
Sept. 11	Purchases................	500 units at	14 =	7,000
Oct. 18	Purchases................	100 units at	15 =	1,500
Nov. 7	Purchases................	<u>200</u> units at	16 =	<u>3,200</u>
Merchandise available for sale		1,800 units		$24,000
Ending inventory on Dec. 31...250 units				

3. **First-in, First-out (FIFO)**
   a. First cost into inventory are the first costs that flow out of inventory
   b. Ending inv. based on most recent cost (most recent purchases)
   c. Unit COGS may be different than unit cost for ending inv.
   d. If inv. cost is increasing, FIFO ending inv. is high (most recent cost)

<u>**First-In, First-Out Method**</u>

Ending inventory is made up of the most recent costs.

Nov. 7 costs	200 units at	$16 =	$3,200
Oct.18 costs applied	<u>50</u> units at	15 =	<u>750</u>
Ending Inventory................	250 units at		$3,950
$3,950/250 = $15.80 per unit			

4. **Last-in, First-out (LIFO)**
   a. Last cost in inventory is the first out
   b. Ending inventory is composed of the oldest cost
   c. If inventory cost is increasing, LIFO ending inv. is low (oldest cost)
   d. Income Tax advantage: Yields lower net income when prices are rising

<u>**Last-In, First-Out Method**</u>

Ending inventory is made up of the earliest costs.

Jan. 1 costs	100 units at	$10 =	$1,000
Feb. 6 costs applied...........	<u>150</u> units at	12 =	<u>1,800</u>
Ending inventory................	250 units at		$2,800
$ 2,800/250 = $11.20 per unit			

B. LOWER-OF-COST-OR-MARKET-RULE (LCM)
1. Accounting conservatism, report an asset at the lower of historical cost or its market value
2. Market value means replacement cost
3. May show higher amount in parentheses

DEPRECIATION

A. Definition
1. Process of allocating asset's cost over period asset used
2. **Depreciation Expense** for period is amount of asset's cost that is used up
3. **Accumulated Depreciation:** Total amount of cost that has been used up over life of asset

Example: The cost of a depreciable asset is $6,000.
The estimated salvage value is $500.
The estimated life is 5 years and 10,000 hours.

B. Straight-line Method
1. Equal amount of depreciation each year
2. Cost - Residual Value/Useful life in years
3. Entry to record depreciation expense
   a. DEBIT- Depreciation expense
   b. CREDIT- Accumulated depreciation

Example
$6,000-$500 = $1,100 ANNUAL DEPRECIATION
5 YEARS

C. Units of Production Method
1. Amount of depreciation depends on units of output
2. Cost - Salvage Value¸ Estimated hours

Example
<u>$6,000-$500</u> = $ .55 HOURLY DEPRECIATION
10,000 hours

D. Double-Declining Balance
1. Accelerated, larger in beginning
2. DDB Rate per year = (1/Useful life in years) x 2 = %
   Only method that ignores residual value

EXAMPLE

Yr.	Cost of	Accum. Deprec. At Beg. Of Year	Bk. Val At Beg. Of Year	Rate	Deprec. For This Year	Book Value at End Year
1	$6000	– – –	$6,000	40%	$2,400	$3,600
2	6000	$2,400	3,600	40%	1,440	2,160
3	6000	3,840	2,160	40%	864	1,296
4	6000	4,704	1,296	40%	518	778
5	6000	5,222	778	40%	311	467

E. Sum-of-Years-Digits (SYD)
Accelerated, larger in beginning:
Step 1. Sum of years' digits = N(N+1)/2, N=useful life in years
Step 2. Numerator = last year of life, count backwards each year
Step 3. Denominator = Sum of years' digits
Step 4. Cost-Residual Value x (Step 2/Step 3)

EXAMPLE
5 + 4 + 3 + 2 + 1=15

Yr.	Cost Less Salvage Value	Rate	Deprec. for This Year	Accum. Deprec. at End of Year	Book Value at End of Year
1	$5,500	5/15	$1,833	$1,833	$4,167
2	5,500	4/15	1,467	3,300	2,700
3	5,500	3/15	1,100	4,400	1,600
4	5,500	2/15	733	5,133	867
5	5,500	1/15	367	5,500	500

F. MACRS DEPRECIATION RATE SCHEDULE

5-year Class Depreciation

Year	Rates
1	20.00%
2	32.00%
3	19.20%
4	11.52%
5	11.52%
6	<u>05.76%</u>
	100.00%

7-year Class Depreciation

Year	Rates
1	14.29%
2	24.49%
3	17.49%
4	12.49%
5	8.93%
6	8.92%
7	8.93%
8	<u>4.46%</u>
	100.00%

LIABILITIES
OBLIGATION TO TRANSFER ASSETS OR PROVIDE SERVICES

PAYROLL

Payroll is employee compensation

A. Payroll deductions
1. Employee income tax
2. Federal Insurance Contributions Act (FICA); Social Security, 6.2% of first $87,000 (2003 limit) & 1.45% of total wages

B. Entries
1. To record Salary Expense
   DEBIT- Salary Expense (gross)
   CREDIT- Employee Income Tax Payable (amounts withheld)
   CREDIT- FICA Tax Payable (7.65%)
   CREDIT- Employee Union Dues Payable
   CREDIT- Salary Payable to Employees (net)
2. To record employer's payroll taxes
   DEBIT- Payroll Tax Expense
   CREDIT- FICA Payable
   CREDIT- State Unemployment Tax Payable
   CREDIT- Federal Unemployment Tax Payable
3. To record fringe benefits
   DEBIT- Health Insurance Expense
   DEBIT- Life Insurance Expense
   DEBIT- Pension Expense
   CREDIT- Employee Benefits Payable

C. Payroll register: Special payroll journal

D. Payroll bank account: Special account which contains the exact amount of net pay to employees for the period

LIABILITIES

A. Current liabilities due in one year or less
1. **Trade Accounts Payable:** Represent amounts owed to suppliers for products or services
2. **Short-term Notes Payable:** Notes Payable due within one year
3. **Discounted Note Payable**
   a. Borrower receives the face value of the note less the interest
   b. DEBIT-Cash (maturity value - interest)
   c. DEBIT-Discount on Note Payable (interest)
   d. CREDIT-Note Payable, short-term
4. **Current portion of long-term debt**
5. **Unearned Revenue:** Revenue collected in advance
6. **Warranty Expenses Payable**

B. Contingent Liability
1. Potential liability that depends on future events which arise from past transactions
2. Recorded if
   a. Probable
   b. Estimable

C. Long-Term
1. **Definition:** Any obligation other than current
2. **Bonds**
   a. Issued at a premium means at a price above par
   b. Issued at a discount means at a price below par
   c. Interest Rates
      i. Contract or stated interest rate is the rate on the bond
      ii. Market or effective interest rate is rate investors' demand in exchange for loaning their money
   d. When bonds are issued between interest dates, accrued interest must be calculated
      i. Investor pays interest from last interest date on bond up to date of purchase
      ii. When interest payment is made, investor receives full amount of interest accrued on bond for period

e. Bonds issued at a Discount - if stated rate on bond is less than market rate
  i. Entry:
    DEBIT-Cash(proceeds)
    DEBIT-Discount on Bond Payable (difference between the proceeds and the maturity value)
    CREDIT-Bonds Payable(maturity value)
  ii. Amortization of the Discount (Straight Line)
    DEBIT-Interest Expense
    CREDIT-Cash (Maturity value x stated rate x period)
    CREDIT-Discount on bonds (discount/number of periods)
f. Bonds issued at a Premium-if stated rate on bond exceeds the market rate
  i. Entry
    DEBIT-Cash (proceeds)
    CREDIT-Bonds Payable (maturity value)
    CREDIT-Premium on Bonds Payable
  ii. Amortization of the Premium (Straight Line)
    DEBIT-Interest Expense
    DEBIT-Premium on Bonds Payable (premium/number of periods)
    CREDIT-Cash (Maturity value x stated rate x period)
g. GAAP requires use of effective interest method
h. Retirement of Bonds Payable
  i. Recognize gain or loss on retirement (Extraordinary)
  ii. Entry
    DEBIT-Bond Payable (maturity value)
    CREDIT-Discount on Bond Payable OR DEBIT-Premium on Bond Payable (For unamortized portion)
    CREDIT- Cash
    CREDIT- Extraordinary gain on retirement OR DEBIT-Extraordinary loss on retirement
  iii. Convertible Bonds-usually convertible into common stock

3. **Lease Liabilities**
  a. Operating leases - short-term, DEBIT rent expense and CREDIT cash
  b. Capital lease - long-term, accounted for like purchase of asset
    i. Entry
      DEBIT-Asset account
      CREDIT-Cash
      CREDIT-Lease Liability (PV of future lease payments)
    ii. Record Depreciation Expense (over life of the lease)
    Record Interest Expense

Discount on Bonds Payable

Amortization by the Interest Method
Example: $10,000 Bond at 6% interest paid due in 5 years.
The bond was sold on Jan. 1, 1990 for $9,792

C1	C2	C3	C4	C5	C6
Year	Interest Paid	Interest Expense	Discount Amort.	Unamortized Discount	Bond Carrying Amount
	6% x 10,000	6.5% x C6	C3 - C2	C5 - C4	C6 + C4
				$208	$9,792
1	$600	$637	$37	171	9,829
2	600	639	39	132	9,868
3	600	641	41	91	9,909
4	600	644	44	47	9,953
5	600	647	47	0	10,000

Premium on Bonds Payable

Amortization by the Interest Method
Example: $10,000 Bond at 6% interest paid due in 5 years.
The bond was sold on Jan. 1, 1990 for $10,214

C1	C2	C3	C4	C5	C6
Year	Interest Paid	Interest Expense	Premium Amort.	Unamortized Premium	Bond Carrying Amount
	6% x 10,000	5.5% x C6	C3 - C2	C5 - C4	C6 + C4
				$214	$10,214
1	$600	$562	38	176	10,176
2	600	560	40	136	10,136
3	600	557	43	93	10,093
4	600	555	45	48	10,048
5	600	552	48	0	10,000

OWNER'S EQUITY

STOCK

A. Capital Stock is the basis unit issued in shares
  1. **Outstanding stock is stock issued to shareholders**
  2. **Shareholders' Rights**
    a. To vote
    b. To receive dividends, if declared
    c. To receive assets in a liquidation after liabilities are paid
    d. Preemptive Right: the right to maintain your proportionate ownership percentage

B. Stockholders' Equity contains two types of accounts
  1. **Contributed Capital**
    a. Capital Stock is Paid in Capital
    b. Preferred Stock
      i. Priority in dividends
      ii. Priority in distribution of assets when liquidation occurs
      iii. Preferred Stock may have different classes; each class is recorded separately
  2. **Earned Capital**
    a. Retained Earnings-increases in equity through profitable operations
    b. Entry to transfer income to the equity section
      i. DEBIT-Income Summary; CREDIT-Retained Earnings
      ii. If net loss occurs: DEBIT-Retained Earnings & CREDIT-Income Summary

C. Issuing Stock
  1. **Common Stock at Par**
    a. DEBIT-Cash & CREDIT-Common Stock
  2. **Common Stock at Premium**
    a. DEBIT-Cash
    b. CREDIT-Common Stock (Par value)
    c. CREDIT-Paid-in-capital in excess of par (premium)
  3. **Issuing Common Stock for other Assets**
    a. DEBIT-Asset(FMV)
    b. CREDIT-Common Stock (Par)
    c. CREDIT-Paid-in-capital in Excess of Par (FMV-Par)
  4. **Preferred Stock**
    a. Accounted for in the same fashion using a preferred stock account and Paid-in-capital in Excess of Par-preferred stock account
  5. **Donated Capital**
    a. Asset received as gift or donation
    b. Entry: DEBIT-Asset (FMV) & CREDIT-Donated Capital

D. Treasury Stock
  1. **Stock issued and later reacquired by company**
  2. **Reasons this may occur**
    a. Company may need stock for distributions to officers and employees under bonus plans
    b. To help support market price
    c. To increase net assets (buy low and sell high)
    d. To avoid takeover by outside party
  3. **Purchase of Treasury Stock**
    a. DEBIT-Treasury Stock; CREDIT-Cash
    b. Does not decrease the number of shares issued, only the number of shares outstanding

E. Retirement of Stock
  1. Once retired, the stock cannot be reissued
  2. No gain or loss arises
  3. Record increase in Paid-in Capital from Retirement of common stock OR decrease retained earnings

COMMON STOCK SUBSCRIPTIONS

Example:
Brown Corporation received subscriptions at $105 per share for 5,000 shares of $100 par common stock on June 21. The subscribers made a 50% down payment on the common stock.

DATE	JOURNAL ENTRY	DEBIT	CREDIT
6/21	Cash (50% down payment $105*5000*.5)	$262,500	
	Common Stock Subscriptions Receivable (50% owed $105*5000*.5	$262,500	
	Common Stock Subscribed (100% stock $100*5000)		$500,000
	APIC ($5*5000)		25,000

On August 14, the corporation received 25% of the subscription price from all the subscribers.

DATE	JOURNAL ENTRY	DEBIT	CREDIT
8/14	Cash (25% down payment $105*5000*.25)	$131,250	
	Common Stock Subscriptions Receivable		$131,250

On Oct. 5, the corporation received the final 25% of the subscription price from all the subscribers.

DATE	JOURNAL ENTRY	DEBIT	CREDIT
10/5	Cash (25% down payment $105*5000*.25)	$131,250	
	Common Stock Subscriptions Receivable		131,250
10/5	Common Stock Subscribed (100% stock $100*5000)	500,000	
	Common Stock (100% stock $100*5000)		500,000

APPROPRIATIONS ON RETAINED EARNINGS

A. Restriction on retained earnings
B. Recorded by formal journal entries
  1. DEBIT-retained earnings
  2. CREDIT-retained earnings appropriated for...

DIVIDENDS

A. Dividend Dates
  1. **Declaration Date**
    a. BOD announces dividend and legal liability created
    b. DEBIT - Retained Earnings & CREDIT- Dividends Payable
  2. **Date of Record:** All those who own stock on this date will receive dividend
  3. **Payment Date**
    a. Date dividend is paid
    b. DEBIT - Dividends Payable & CREDIT - Cash

B. Cumulative Preferred Stock
  1. All dividends must be paid before corporation pays any dividends to common shareholders
  2. Any dividends not paid are considered to be in ARREARS

C. Participating Preferred Stock
  • May receive dividends beyond stated amount or percentage

D. Convertible Preferred Stock
  • Can be exchanged for another class of stock

E. Values of Stock
  1. **Market Value:** Price a share is bought and sold for
  2. **Redemption Value:** Price corporation agrees to pay for stock after it's been issued
  3. **Liquidation Value:** Only preferred stock, amount corp. would pay if liquidated
  4. **Book Value:** Amount of owners' equity on the books for class of stock

F. Stock Dividend
  1. **Proportional distribution of corporation's own stock**
  2. **Reasons for stock dividend**
    a. To continue dividends but conserve cash
    b. To reduce market price of share of stock
  3. **Categories of stock dividends**
    a. Small stock dividend (less than 25% of stock issued)
      i. Recorded at FMV at date of declaration
      ii. DEBIT-Retained Earnings (FMV)
        CREDIT-Common Stock Dividend Distributable (par value)
        CREDIT-Paid-in-capital in Excess of Par-common
      iii. On the distribution date
        DEBIT-Common Stock dividend Distributable (par)
        CREDIT-Common Stock (par)
    b. Large stock dividend (> 25% of stock issued)
      i. Recorded at Par value
        DEBIT-Retained Earnings (Par value of stock)
        CREDIT-Common Stock Dividend Distributable (Par value)
      ii. On the distribution date
        DEBIT-Common Stock Distributable CREDIT-Com. Stk.

G. Stock Splits
  1. Increase in number of shares authorized, issued and outstanding
  2. Stock splits affect NO accounts
  3. No formal journal entry is required
  4. They reduce the par value per share

STATEMENT OF CASH FLOW

A. Reports cash receipts and cash payments during a period
B. Cash means cash and cash equivalents
C. Three sections
  1. **Operating Activities**
    a. Revenues and expenses from firm's major line of business
    b. **Collections from customers** =
      i. Sales Revenue (+ decrease in A/R or - increase in A/R)
    c. Receipt of interest and dividends
    d. **Payments to suppliers** =
      i. COGS (+increase in inv. or - decrease in inv.) and
      ii. (+ decrease in A/P or - increase in A/P)
    e. **Payments of operating expenses** =
      i. Operating expenses other than salaries, wages and depreciation (+ increase in prepaid expenses or - decrease in prepaid expenses) and
      ii. (+ decrease in accrued liabilities or - increase in accrued liabilities)
    f. **Payments to employees** =
      i. Salary and wage expense (+ decrease in salary and wages payable or - increase in salary and wages payable)
    g. **Payments of interest and taxes**
  2. **Investing Activities**
    a. Increases and decreases in cash due to dispositions or purchases of firm's assets
    b. Sale of plant assets
    c. Sale of investments
    d. Cash received on loans receivable
    e. Acquisition of plant assets
    f. Acquisition of investments
    g. Loans made
  3. **Financing Activities**
    a. Increases and decreases in cash from investors and creditors
    b. Stock issuance
    c. Sale and purchase of treasury stock
    d. Borrowing money
    e. Payments of dividends
    f. Payments of principle on debts

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