Intro: I: Financial accounting for dummies

* Accounting: Language of business (facts: internal, external parties)
* Internal: employees, external: Investors, creditors, Regulatories, IRS, Securities
* understandable, materially correct financial statements: Income, Balance, Cash flow

Four important characteristics:

1. Relevance (hallmark)
2. Reliability
3. Comparability
4. Consistent.

Accounting: organize facts & figures + result in an understandable way!

Financial accounting: Involves generating financial statements.

Information: Transaction (Revenue, Expense, asset buy/sell)

Business entity: Company

Users: Internal/External.

Rules: GAAP (Generally Accepted Accounting Principles)

Financial Statements:

1. Income Statement (P&L) (Revenue, expense, Gain, Loss): Net income, Net profit)
2. Balance Sheet (Asset, Liability, Equity)
3. Cash flow (cash sources, Cash paid out, received)

* Income statement: 12 months (Compare previous historic performance)!
* Balance sheet: From day 1 to current (when generated).

CPA

* publicly traded Companies: Bring certified Public Accountants!

Users: Investors (current/likely)
creditors, vendors, Govt, Bank
Securities, Exchanges!

Why?

* Materially correct: No serious/substantial misstatements!
(Is it investable (creditors/investors), Govt: Abide by rules!

Information:

* Invest? (people's money) : grow?, Able to pay? (Dividend)

1. Relevance:

* Hallmark of good evidence
* Inclusion / Absence of info : affects user's decision
* Feedback value
* Timeliness (late means useless)!
* SEC : Requires report certain reports within 60days of financial period.

2. Reliability:

* Free of mistake / bias
* pending lawsuit (likely against) : must Include! (Neutral)
* Need Independent evaluation of 3rd party : check report : Bills, Invoices...
* Representational faithfulness : $200K Revenue : $200K receipts!

3. Comparability:

* Compare among companies / different time frame : CPA
* eg : model, facts, hardware (Laptop)
* GAAP may differ (other Countries) : hard to Compare Sometimes

4. Consistent:

* Same type of accounting (In a period)
* Compare dog to a cat (Lack Consistency)
* Disclose in foot notes :
* Depreciation : Reclassify asset value throughout life!
  Different methods : Unless exactly known : can't decide!

> **Conservatism:** In doubt, choose least favourable effect on income / expense!

CPA: (4 part exam)!

★ Abide by AICPA: American Institute of CPA

(Generate reports: others)

★ AICPA: responsible for establishing accounting, auditing, attestation standards

★ Even non CPA's still abide by code of conduct.

★ Integrity: Do right even if it is not self profitable (serve you best)!

- Objective: Impartial, honest (unbias, report facts)
- Intellectually honest: Rules & policies in truthful manner.
- Compromised: No value in reports you generate! (No hope)

Independence:

★ No relationship (No self service)!

★ No financial interest (may profit/loss you)

★ Consultancy service: not independent but still must be objective!

$\boxed{\text{FASB (Fin Acc Std Board): Conceptual framework!}}$

Chapter: II: 3 Financial statements

★ Financial statements: End result of accounting!

★ process of classify, record, Display!

★ Internal users: Bird eye (performance): cash?, Revenue good? Too much expense!

Balance Sheet:

★ Snapshot as of date (Financial position)

★ Double entry system (every action = equal reaction): Credit - Debit

Classified Balance Sheet: Group similar accounts (cash, AR): Current asset

(AP: Short term liability)

Ease (No hunt)!

Not all are geeks (Some don't know long/short term)!

> 1 yr

< 1 yr

Asset:

★ Company owns (cash, AR, Inventory, Fixed assets, prepaid expenses, Other assets)

★ Cash: operating checking account (Receive payment, pay business)

Petty cash: Small maintainance, Small amounts! (Fixed amount of cash)

* petty cash: bill/Coins for daily expenses (Toilet paper)!
* AR: Net 30, 60...
* Fixed asset: property, plant, equipment (Long lived tangible: Car, land, Computers)
* other asset: security deposit, advances!

Liability:

* AP, payroll liability, Notes payable
  - AP → vendors
  - payroll liability → Lag in payment
  - Notes payable → short term: 12 months (current year portion of LT) Bank, Mortages

Equity:

* Retained earnings, paid in capital, Additional paid in capital.
  (Net profit - dividend)

Stock: $10 → paid in capital (stocks sold)

paid: $15 → $5 (par) → Additional paid in capital.

$\boxed{\text{Treasury Stock: own stock bought back}}$
→ part of equity (Not part of paid in capital)!
→ Reduction in equity (Shown as)

Classified Balance Sheet (Dec 31 2023)

Assets	
Current Asset	10
PPE (prop, plant, equ)	20
Total assets	30
Liabilities	
Current liabilities	10
Long term "	20
total "	30
Equity	
Paid in Capital	0
Retained earnings	0
Total equity	0
Total Liab + equ	30

Asset = Liab + equ

$\boxed{30 = 30 + 0}$

* Basic acc equ
* Balance sheet equ!

Income statement:

* Income/exp from continuing operations & other sources (sell asset)
* Scorecard (how performance is for a period)
* Historic trend: compare over periods
* Retained earning: Accumulate total net income/loss from day 1. (Not specific to a financial period)

$\boxed{\text{Income Statement: Revenue, COGS, operating expenses, other gain, loss}}$

1. Revenue: Inflow of asset (cash, AR) → sales/ gross sales/gross receipts

Deduct sales discounts, Returns, allowances

2. COGS: Cost associated with directly selling a product/service.

$\boxed{\text{manufacturer: How much to make, distribute; merchandiser: How much to buy \& resale.}}$ → raw materials, Labour, factory overhead (all costs to make)

3. operating expense: operations directly tied to COGS

Selling: Salary, Commission, advertise, storing, depreciation (furniture, equipment)

General & Ad expense: Keep up normal operation (office supply, payroll, rent, utility, Legal fee)

4. other income & expense: Interest, dividend paid, Loss on disposal, profit on dispose

eg:

Net revenue	50 K
COGS	35 K
Gross margin	15 K
operating exp	5 K
operating income:	10K
other gain/loss:	3K
Net income	7K

Show money: cash flow statement

* Cash source, how spent!
* How much earned, collected, have?

* Track source, use!

* 2 ways
  1) Eliminate AR, AP accounts
  2) Show cash brought in by continuing operation, paid out for cont. op,

Sections:

1) Operating (Income Statement) : Remove AR, AP, Inventory
2) Investing : sale/purchase of long term assets (also affects balance sheet & Inc St.)
3) Financing : long term liability (loans), equity items (stock, dividend)

↑ in asset / ↓ in asset

eg:

Cash from op act :	9000
Inv act :	(8000)
Fin act :	(250)
Inc/ in cash Dec	750
Cash bal (prev: Jan 1 2021)	2250
Cash bal (Dec 31 2021)	3000

Direct method : Cash receipts, disbursement

Indirect method : Start with net income (Income Stat)
↓
adjust noncash (Depreciation)....

chapter : 3 : Running the numbers for success

* properly enter, interpret, make decision/report
* Easy to switch sole proprietorship → S corp!
* Sole proprietorship : easy to start, maintain (least cash), proud owner!
  No need for Balance Sheet for tax purposes
  File : owners profit/loss form (no seperate forms)!
  No employees : no employee forms!
  paid whatever amount!

Owner's capital:

* Deposit/personal bank account! → own inventory (fair market value) Record in asset!
* Unrelated 3rd party would pay (fair value)

Total pay amount = Total asset − Liability (Total cash − Cost of raw material)

↳ No taxes from withdrawing (write a check from equity)

S corporation:

* Limit liability. (Seperate from you)
* paid like an employee (not by draw), Tax filing (employee) must!
* owner: Shareholder (Purchase your own stocks)
* Tax filing: Sharehold will file tax return!

Airline Industry: Non refundable ticket (record next day)

Refundable : 6 to 24 months

Amortized: Transfer Income statement (initially Balance Sheet) later!

Service

Service revenue		85K	
op exp			
Selling expense		[550]	
Ad exp	[550]		
General & ad			→ Income, General exp, admin exp...
Office Salaries	50K		
Supplies	2.65K		
Insurance	650		
Utility	895	$\boxed{\$54195}$	
Total Selling & op exp		$54745	
op Income		$ 30255	

Sales

Sales 145K

Sales disc [550]

Retu & allow [1K]

Net Sales 143450

CoGS:

Beg inventory : 890

purchases : 63745

Freigh in 645

Cost of purc 63390

purchase disc 250

Ret & allow 750

Net purchase 65390

CoGS for Sale 66280

Ending inv 1100

CoGS sold 65180

Gross profit 78270

op exp

Selling exp

Salary
Commission
Ad
→ 24550

General & admin exp

office salary
supplies
Insurance
Rent
Utility
→ 48175

Total op exp 72725

Op income 5545

Salon: Sells Shampoo, Conditioner
main: Service, product Sale
↓
Subordinate!

Analyze:

* 38K good profit? (How many returns to earn), Salary high? (To employee)
* Evaluate profit margin? Cost issues? (Trend analysis)
* make a budget! (Estimated from revenue, expenses)

$\boxed{\text{Horizontal analysis: Different periods} \\ \text{vertical analysis: Different accounts}}$

Cash budget (cash planning): early warning! (Shipping cost high) → Charge more / → change partner

manage Cash: (Check bounce: negative effect!)

* Business may fail:
* Cost issues: Jan (4K), Feb (−10K) : Budget forecasting
  - → Reduce Jan purchases/use account (credit)
  - → Slow down payment of AP/ expenses
  - → Short term loan

Bank reconciliation

* Check (undeposited) by us/customer
* Interest debit/credit, Bank charges

} → may only known after statement from Bank.

Bank: Credit: I deposit (why?)
Debit: I withdraw

You: Debit: ↑ in asset
Credit: ↓ in asset

$\boxed{\text{my money: Liability for bank}}$

Example:

* Cash Account Balance: \$4797
* Bank Balance: 3652
* Service charge: \$25, \$5 interest
* NSF: \$875 (one cheque bounced in my bank)
* \$750 deposit not showing up.
* \$500 (I sent not deposited by my vendor)

Bank	my account
\$3652	\$4797
750	5 → Credit (int)
(500)	(25) → Debit (Bank charges)
	(875) → NSF
3902	3902

Cash to accural:

* Cost of buying inventory : Not comes in income statement!
Until it is matched (Revenue earned)!

IRS allow 50% deduction on entertainment expenses (Dinner 100
50: deducted)

Cash received to Revenue earned:

Cash received − Beginning AR + ending AR = Revenue earned

Cash payments to operating expenses

Cash paid for exp + Beginning AP − Ending AP = Op. expense incurred.

Working capital loan: expect paid back from sales & collection of AR (within 12 months)

Note: Cash, working capital loans: doesn't affect current ratio. (cancelled out)

Revolving line of credit: Lend (make periodic payments)

4. Standards for financial accounting

* AICPA: American Institute of CPA: sets financial codes!

* publicly traded, private companies abide by different standards.

AICPA:

* maintain ethical code (CPA)

* CPA: informed about stds great resources to refer.

* Through ASB (Auditing Std Board): establish Audit & attestation std for non public companies in US.

ASB:

* Stds & procedures: CPA to follow: attestation/audit to non public companies

* 19 members (mostly from public firms): professors, govt accountants...

* 1-3 yrs (nominated by director of AICPA, ASB board)

AICPA 6 principles:

1. Responsibility
2. Serving public interest
3. Integrity
4. Objectivity & independen
5. Taking due care
6. Scope & nature of Services

* Auditing: Enough evidence to issue an opinion (free of misstatements)
* 3rd part need to attest (takes responsible): make sure correct!
* Auditor must mention whether he/she follows GAAP, Responsibility disclosures

Responsibility:

* High moral, ethical standard (peer review): check accuracy & consistency.

Serve public interest:

* To whom preparing + users of the report (Banks...)
* who rely on objectivity & integrity

Integrity:

* Honest with dealing, serving: Best of ability (without fearing firing)

Objectivity & Independence:

* neutral & unbiased: only on facts. Follow GAAP
* Audit/attestation: independent (no special relation)

Due care:

Have education & knowledge (enough professional activity: responsible)

Scope & nature of services:

* Consider all 5 & accept if they can satisfy!

Sarbanes – oxley Act (SOX): 2002

* PCAOB (Arm of SOX): public company Acc oversight Board.
* SEC make sure public companies: tell truth.
* SEC has 5 commissioners (5yrs): president appoints
* No more than 3: same political party! (License, regulate: public companies).
* Submit quarterly/annual reports! (online DB: EDGAR)
* Insider trading/violations: Took actions against individuals.
* Works with criminal law enforcement agencies: prosecute individuals & companies alike for offenses that include criminal violations.

Sox: 2002:

* Bankruptcies of Enron Corp: Billions of dollars lost
* 11 sections
* PCAOB (public Company Accounting oversight Board): watchdog of Accounting & auditing professions.

PCAOB: private, non-profit

* 5 members (2 members: CPA)
* Chairman (Eron & CPA: non active atleast 5 years)
* Full time: 5yrs commitment.

FAF (Financial Accounting Foundation) 1972:

* private sector: establish GAAP for all non-govt entities.
* 7 members (Knowledge of Accounting, Finance, Business)

SEC, PCAOB: works together (Chit chat, make a decision) Conference!

EITF (Emerging Issues Task Force)

* Identify issues to standardize
* Six times a year meet: To discuss!

GAAP:

* How to show up data in Financial Statement
* eg: Asset, Liability, Equity on balance sheet not on P&L!
* FASB sets standards for both public, private, non profit
* SEC: public held companies (confirms authority), SEC depends on private bodies to set standards.

*

5. Accounting process

I * Booking: collect & record transaction (clerks): Journal entries
* Chart of accounts: list of all accounts.
* General Ledger: Record of all financial transactions!
* Each account has unique code (3-4 digits)

Income: (4000-4999)
Expenses: (5000-9999): COGS, [op, gen, admin exp]
non-business related inc/exp

Equity: 3K

purchase equ: 725

Raw material: 275

1K prog: 500 (adv), 500(Yet to pay)

1800 (Sales)

Assets, expense: Debit ↑
Liability, revenue, Equity: Credited ↑

→ "different from add, Sub"

5 Step process:

1. What's going on (Buy, Sell..)
2. Accounts affected
3. Debit / credit
4. Debit = credit
5. Makes sense? (can't credit an expense to record revenue)

Journals:

* Book of original entry (No transactions get into Accounting records without Journal entry)
* eg: cash receipt Journal (cash, credit card, checks)
* Dividend / Interest (Though) Passive → IRS tax purposes it's not! (Portfolio income)
  ↳ Sometimes recorded in General Journal (Cash: inst)

cash Journal: (payments, sell asset, dividend, Interest, sales (pettycash), cash payments

* Debit columns: Cash, Sales discount
* Credit columns: Sales, AR, Sales tax payable, Miscellaneous
* Additional: date, Name ~~of~~ accounts

Cash disbursement Journal: (merchandise purchase, outstanding payments, Expenses)

* Credit: (Cash, purchase discounts)
* Debit: AP, miscellaneous
* Additional: Name (account), vendor, date

Accrual transaction: (2 workhorse Journals: Sales, Purchase)

↓ Sales on account

* Sales return (After sales done: products returned)

* $\boxed{\text{Recorded in general ledger!}}$ → Not Sales Journal
  (Journal)

* purchase Journal: on credit purchases! (date, number, Amount)
  * A.P, Terms!
  * purchases!

* other Special Journals: payroll Journal, | Sales " & " / purchase return & allowance Journal

★ General Journal : Catchall (where belong in no other Journal) : Interest, Dividend

Adjusting Journal entries:

★ Earned, not yet paid ($5K) : payroll may 2 (earned April 30)

wages expenses :	5000		→ April 30
wages payable :		5000	
cash :		5000	→ may 2
wages payable :	5000		

★ Reclassify transaction (fact changed)

Cash		1000	→ April 1
Inventory	1000		
Sales	200		→ April 30
Inventory		200	

★ closing Journal entries (Zero temporary accounts for a period) → Balance sheet

★ Debit all Revenue, Credit income Summary (Temporary account)

★ credit all expenses, Debit to Expense summary account

★ Take the figure to retained earnings! (credit/debit) : net income

Income Summary	5K	
Income Summary		7K
Credit :		2K

equity (Retained earnings) : Credit (↑)!

↳ Finally (any dividends) : debit from R.E & credit to Div acc!

Balance Sheet accounts : Permanent!

↳ Never Zeroed!

Date	Debit Acc	xxx	
	Credit Acc		xxx

★ Can have more than 1 debit/credit (number of credits shouldn't necessarily be equal to number of debits)

★ Amount must match (debit = credit)

Invoice #3200, $1400, $1000 paid

15-5-21	Cash	1000	
	AC/R	400	
	Sales		1400
	#3200		

→ Brief explanation!
why this entry (description)
Understandable.

Borrow 3K (Aug 1), Aug 31 : 150 Interest, pay back loan + 150 (Sep 30)

1)	Cash	3K		1-8-21
	Notes payable		3K	(Bank loan)
2)	Interest exp	150		31-8-21
	Cash		150	(Interest)
3)	NP	3K		30-9-21
	Interest	150		
	Cash		3150	(pay back + Interest)

3K (Contribution) → Bank, equipment : 725 (Account), Inventory : 275 (cash)
programmes (500 paid), Revenue 1800

1-4-21	Cash paid-in-capital (owners contribution)	3000	3000
2-4-21	Equipment A.P (equipment)	725	725
3-4-21	Inventory cash (raw materials)	275	275
4-4-21	Programming expense Cash AP	1000	500 500
5-4-21	Revenue Cash	1800	1800

* Journals: Books of original entry
* Ledger: Transactions in a cycle (Big book)
* General ledger: 1 big dog ledger (all transactions)
* Subsidiary ledger: payroll, AR (Specific transactions)

* Post in Journals
* Record in correct ledger

eg:

	Type	Date	No	Name	memo	Debit	Credit	Balance
4050 - Consulting fee								
					coloring			
	Deposit		7		painting			
	Deposit		2					
			3	John	moving			
	Deposit							
	Invoice		1	July				
	Check		2	James				
						54500		54500
								0.00
Bank charge								
	Bankfee		14		Bankfee	15		15.

why trial balance

* purpose: To Review, make sure Debit = Credit
* Accounting Software: Never allows out of balance entry (credit ≠ debit)

All accounts : Debit? Credit? (or Balance only)

ACC 1	100	200
ACC 2	200	100
	300	300

or

ACC 1		100
ACC 2	100	
	100	100

chapter 6: methods & concepts

Cash method:

* fails to match : Revenue to the expenses: Company incurs to earn that revenue.
* 72K (Revenue), 18K expense : (32K cash), (Rest: account)

  Net income: 14K (Inaccurate if paid on account)

  Net income: 32K (If purchased on account)!

* Earned: when job done! (Realizable : as likely)
* Job done but bounced check (cx gone): earned, not realizable! → Not recorded as revenue (Accrual)

$\boxed{\text{Cash method: didn't recognize this event (not changed hands)}}$

Accrual method:

* Record when earned & realizable (expense: incurred)
  - earned → satisfy contract
  - realizable → collecting money from cx
* Have AR, AP accounts!

Accounting fields: managerial, non profit, Govt, International

$\boxed{\text{★ Govt entities: Follow ASB instead of GAAP}}$

Managerial:

* Economic, Financial info: Internal user: HR, CEO, ... make decision!
* Decision: employing, quality, performance!
* managerial reports: Frequently issued (Internal)
* IMA: Institute of Managerial Accountants (guidance, codes..)

Non profit:

* net income: exempt from tax : prepare budget, prepare application!
* Budget: manage, fundraising
* GAAP has to be followed by all non-govt orgs. (Unless specifically excluded)
* Groups accounts/funds: Based on purpose

Governmental:

* City/State/Federal govt agencies: Non-profit motive!
* Cash sources, budget
* Source: Tax (property), Govt funds, License, permit, Penalty, Bond!
* Report: open to public (Stay true)
* Regulatory: GASB : Govt Accounting Std Board

International accounting:

* MNC : managerial, tax return, auditing
* Deal: Foreign currency translations
* Risk: siezed by govt (host), Block funds
* IASB: Regulatory, IFRS, GAAP : coexisting!

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4 concepts: objectives, characteristics, Elements, Financial statement measurement

Objectives of fin reporting:

* Record properly (classify) : Arrange in appropriate statement (P&L, BS, Cash St)
* Report to users

Characteristics:

* Adding wrong ingredients : spoils dish (reports too)
* Understandability, Relevance, Reliability
  - Understandability ↓ can realize facts
  - Relevance ↓ enough to decide
  - Reliability ↓ Neutral, verifiable, materially correct

elements: which elements are shown at which report!

Financial statement measurements:

* Communication requires measurement (cost, value)
* cost/value (historic cost : how much paid during transaction)
  (net realizable value : Anticipate to receive/pay)

Chap: 7. Balance sheet : Asset section

* current asset: liquid (checking account, AR, inventory) : cash/easily turn to cash
* Non current : Takes time/result in loss : Tangible (car, computer, building, office) (Touch)
  Patent, trademark, pattent : Intangible.

Historic cost:

* Fair market value : unpressured person will pay in open market!
  2021: 200K, 2024: 600K
  $\boxed{\text{But in balance sheet: 200K (Book value)}}$

* If depreciated: $\boxed{\text{Asset's net book value = Historic cost − depreciation cost}}$

→ Most asset will show up as historic cost (previously bought) instead of fair value!

Current asset:

* less than 12 months: converted to cash
* Balance sheet: list accounts based on liquidity (cash comes first)
* Common: Short term investment, AR, Notes receivable, Inventory, Prepaid expenses

* Cash: Any account backed by cash (checking account, operating account, merchant account (credit card transaction deposit), payroll account!
    * why seperate bank account: Safe business environment (Limited access)
    * current account!
    * operating checking accounts: Business activities, deposit revenue, pay bills
    * payroll checking accounts: pay employees (Transfer from operating account to pay empl)
    * merchant account: credit card (only deposits): withdraw to operating account
    * petty cash: small daily expenses (cash box)
    * sweep account: Earn investment income (Transfer to investment accounts)

* Short term investment: Stock, debt (not own debt/equity): others companies
  Plan to sell with in a year (Trading, maturity, available for sale)

* Trading Securities:
    * Balance sheet: original value
    * Unrealized gain/loss: Income statement (Fluctuates: adjust!)
      (paper)

1000K: Invested!

Asset: 1000K
unrealized loss: 100K (adjust at end of the month)

* Held to maturity Securities
    * Not adjusted!

* Available for sale Securities:
    * Not Trading, Held to maturity: unrealized fluctuation recorded when determined! (otherwise shows as accumulated / comprehensive income): Balance sheet
    * If determined: adjusted (unrealized gain/loss)!

* \$5300 (fair value): unrealized gain (300)
* Tax: 75 (25%) ⟶ Accumulated Income = 225

Tax deferral effect! (In real life : Timing!

GAAP (uncollectable accounts):

* valuation adjustment for uncollectible accounts (Bad debt)
* past experience (2% uncollectible) : make estimate
* make allowance for baddebt { Debit : bad debt expense account
  Credit : Allowance for uncollectible accounts)

* Contra account : Carries opposite balance to the account's normal balance

* Normal account (asset) : Debit
* Contra account (Allowance for uncollectible accounts) : credit
  (Accounts Receivable valuation account)
  ↳ Reduce AR account

Net receivables = AR − Acc. Rec. valuation account.

* Until made sure, a Cx won't pay : AR valuation account (not tied to any customers)

Adjustment!

AR	500
ARVA : 500	

Notes receivable:

* Cx with cash problems (yet to pay) : Formal doc (Short term loan)
* principal, interest rate, time!

Increase Notes payable (Debit)
Decrease AR (Credit)

Inventory:

* Retail (from merchandise) : purchase (↑ Inventory, ↑ AP)
* product (manufacturing) : Raw material, Incomplete, Finished

Different valuation methods

prepaid expenses:

* pay for an expense in advance (insurance), pay rent, interest!
* Each month : adjust as used!

Long term asset:

* Immovable, mature > 12 months (NP > 12 months)
* Gold, diamond, Timber, oil, coal : non-current assets
* PPE (property, plant, equipment) : Tangible (fixed)
* Depreciation: Move cost of using from BS to P&L (Income)!
* Land: Real property: Contract price (purchase cost)
  closing cost (entitle: charges): Brokers, legal, insura
  Survey cost (to surveyor)
  Land improvements (plant, fence, sidewalks)

→ Never depreciated! (Recorded in investment rather than PPE)

→ sell < 12 months : current asset!

* Building: plant, shop, inventory, office, warehouse
  Depreciable!

* GAAP: List land & buildings seperately! (Appraisal to calculate values)
  raw land, buildings!

* Equipment: Computers, machineries, cash registers, ladders.
* Furniture & fixtures: tables, conference, rugs, display cases..
  Leased: don't show up (If passed ownership criteria of GAAP): Can list in Bal sheet.

Intangible assets:

* No physical presence: Long lived, Short lived (goodwill): bought > fair value (other comp)
  → Leasehold improvement (update: when rent over can't take it!)
  patent, copyrights,
  Trademarks

$300K, But bought for $400K : $100K in goodwill

writeoff intangibles with ammortization:

* mimics depreciation, use useful life time (patent: 20 yrs)
* Balance sheet cost: Cost of purchase/improvement (Basis of amortize)
  Cost of developing, a value (phrase)!
* Goodwill: Never ammortized (writeoff any needless goodwill)!

* Current assets (highly liquifiable): comes first
* List PPE next with accumulated adjustment.
  (Ammortization)

Debt: Liability : Chapter: 8

* AP (vendors), unearned revenue (Deposits), Salaries payables
* GAAP: breakout current, longterm obligations (1yr mark)
* Current liability first, then long term liability (Accrual & Incurred)

Why division?

C.A − C.L

* Glean info necessary to compute liquidity, working capital, current ratio ($\frac{\text{Asset}}{\text{Liability}}$) curr
* Loan: working capital (can pay back).
* Rare: Net current assets with current liabilities (under GAAP)
  ↳ 'Doing so': Can't analyze ratios!
  Purchase: Inventory ↑, AP ↑
  If both as 'net': Can't determine more info!

* GAAP: A/P is always assumed to be current liability!
  But can eventually reclassified as Long-term Liability (couldn't pay agreed loan!)
* AP/Trade payable (synonymous)
* Trade payables: business supplies, direct materials to manufacture
* AP: All short term vendors! (But both: AP usually used)

1/15: 1% discount if paid within 15days

1/15 net 45: 45 days (net), 1% dis paid within 15 days

'Debit/credit: Word won't show up in Journal entries'

1) Inventory	1000	
AP		1000
2) AP	1000	
Cash		990
Pur disc		10

Payroll & taxes:

* Nature: accrue taxes & pay later!
* Current liability: Arrears amount!
* Payroll taxes, benefits (FICA)
* FICA (match employee's contribution 50%)
* Social security, medicare (6.2%, 1.45%)
* State, federal (SUTA, FUTA) unemployment tax
  ↳ vary based on claim rate!
* Federal tax, state, local tax
* Insurance, 401(K), Retirement

wages exp 60K

wages pay (net) 47955

FICA payable 4590.

Income tax payable 3680

Health ins payable 1200

Retirement : " 2575

pay roll Tax expense 5075

FICA (employer match) 4590

FUTP 80

SUTP 405

Unearned Revenue:

* Not Service/good delivered

* obligated to fulfill Contract!

$120: Year Subscription

* ~~Cash~~ 120

Current liability 120

* ~~Sales~~ ~~12~~ 12

C.L 12

→ Adjustment entry!

↳ Credit Sales

Debit unearned revenue.

Short term liability: (High means : No excess money): more debt

* Short term loans (working capital loan)
* Current portion of long term loans (morkage: This year)
* Estimated warranty (guarantee: Service / replace) : Free of charge!
* Revolving line of credit (fixed amount loan)

↳ Disclose in footnotes

Estimate (In reports)

In % of Sales

* warranty expense 3.5K

estimated warr liab 3.5K

* 3500 (warranty), Labor (1500), material (2K)

Estimated warranty Liability 3.5K

Labor exp 1.5K

material exp 2K

Long term obligation:

* current debt: meet current obligation
* Assets: Long term debt!
* Corp → Debt (expect more return than Interest paid)
  → Equity (Not obligated to buy back) : more voices to be heard

Interest payable: Tax deductible

Dividend payable: No!

eg: student loan (2%)

aunt give: 2K

Invest : 3%

$\boxed{\text{extra 1\%}}$

* Long term debt: morkage, NP, leases, bonds
* morkage: Collateral (property), Sieze if not paid.
* Lease: Uptodate (Lease Computer!) : As need to replace often!

★ Contingent liability: non-current liability

★ may cause future loss → pending litigation (lawsuit)

→ Guarantee of obligations (agree to pay for other Company)

Footnotes: mention → Not as part of Financial Statement (Not accrued/incurred)

★ chance: probable, (Backup guarantor (if person I signed unable to pay/missing)

→ Reasonably estimated!

Account: Loss on guaranteed debt
Amount due on guaranteed obligations

Bond Issuances:

★ Short/long term (municipal, corp) : Interest

★ matures: Company pays face value

★ Financing/Investment!

★ premium: effective yield/market rate

→ market rate lower than bond rate!
(for more interest (bond value): premium rate)

face value : value of bond
Discount : < than face value
premium : > than face value

Face value:

★ Cash 50K
Bonds payable 50K

★ Bond interest 2.5K
cash 2.5K

Premium:

face value: 400K, 10%
103% : premium

Cash : 412K
BP : 400K
premium on BP : 12K

12K: Ammortized (write off over time) : Straight line method each year: 1.2K

Bond discount:

★ 400K @ 97%, 10yrs, 10%

Cash 388K
BP 400K
Dis on BP 12K

→ Ammortize 12K bond discount 1.2K each year

Interest payable 40K
Int expe 38.8K
Disc on BP 1.2K

→ Ammortization!

Retiring / converting bonds:

* Pay back (BP: Reduce to zero), Regular ammortization (zeroed)

Face value:	
BP	400K
Cash	400K

Callable: Issuer payoff before maturity. Must written off remaining ammortization

Convertible bonds:

* Debt → equity!

attractive:

* Dividend > interest
* Value ↑ over time

Chapter: 9: Equity section

* Each & every owners contribution (Net asset = asset, − Liability)
* Sole proprietorship, corp, flow through entities (partnership, S-corp)
  ↳ Special tax corp!

$$\boxed{\text{Stockholders equity} = \text{Stock} + \text{additional paid in capital}}$$

Stock ↓ Face value

additional paid in capital ↓ Extra paid

Sole-proprietorship:

* Single owner: Can't own with even spouse (easy to form), no formal filing
* owners capital, owners draw
  ↳ Takes from the business (personal use)
  ↓ Contributions (equipment, investment)

Partnership:

* Atleast 2 (holding any % of business), combined = 100%
* Agreement, Paperwork. (general partnership: All partners personally liable legal action, debt
  Limited liability: Limited to your investment, don't have any say in run!)
* partner capital account, partner capital draw.

$\boxed{\text{2 equal partners: draw amount may be different!}}$

Corporation:

* Incorporate (charter): name, address, stock it issues
* Stockholders equity (claim in net assets) → Components (3)
  * paid in capital
  * Treasury stock
  * Retained earnings

paid in capital:

* money invested by share holders
* preferred, common, additional paid in capital! (subset of paid in capital)

* preferred stock: ownership in corp (traits of both debt / equity)
  while closing: need to settle invested + dividend (Before regular stockholders)

* common stock: Residual ownership (Remaining stocks)
  elects board of corp offices (Real Corp: Atleast 1 common stock)

$10 Face value, $20 (sold)

paid in capital = 10
Additional paid in capital = 10

GAAP: describe transaction on balance sheet properly

preferred: (Debt like characteristic): Has to pay face value!

Rules to issue the stocks:

* Limit no. of shares (authorized, issued, outstanding) at any time
* Custodian of stock: employee / unrelated registrar: keeps track of no. of shares (outstanding) to make sure no more stocks issued!

Authorized: upper limit on no. of shares
Issues : sells (cash / benefit)
outstanding: sold (until buyback: treasury)
Common:

while starting company: Decide no. of shares (region: may change)
Future: may increase

* 750K : stocks authorized
* 275K issued (Jan1)
* 200K " (Feb1)

outstanding : 750K
Sold : 475K

Retained earnings account = Total net income/Loss from first date.

Paid in capital : Contributed by shareholders
Retained earnings : Earned

* Dividends ↓ Retained earnings
* Reduce equity (dividend, treasury stock): Both different!
* Any correction (previous period): Corrected now: Reduce equity

Dividends:

* Distribute (Shared) earnings to the shareholders (Cash/Stock)
* Dividends: Not expenses (Balance sheet transaction: ↓ cash, ↓ retained earnings)

5% Stock dividend:

* 30000 shares: $10 par value (common stock), Fair market value: $15.
* $22500 → reduce retained earnings
  ↳ $1500 stocks (15000 + 7500)
    ↳ increase paidin capital: 15000
    Add. paid in " = 7500

Lifecycle

1. Declare: (Board meeting / doc release)
2. Record date
3. payment date

(or)

Common stock dividend distribution = 15000
Add. paid in capital: 7500
Retained earnings: 22500↓

issued

Common stock divdds = 0↓
Common stock ↑: 15K
(paid in capital)

Treasury stock:

* Bought back by issuing corp (Contra stockholders equity account)
* Contra accounts: Carry opposite balance to normal account balance.
* Equity: credit, Contra: Debit

GAAP: Not appropriate to gain/loss on treasury stock transc.

Why buyback:

* Hostile takeover
* Low stocks: Low chance of controlled by another company!

Stocksplit:

* Doesn't reduce retained earning: Just ↑ no. of shares
* Give proportionate amount of shares (own)

* Why: Trading at a higher price (Reduce price per share)
* 4 for 1 (For every stocks, 4 split) 1 → 4
* Common stocks (1000 : $100) $\xrightarrow{4:1}$ 4000 $25
* Dollar value : Same!

Accumulated other Comprehensive Income:

* Revenue, Expenses, Gains, Losses under GAAP: part of comprehensive Income (not included in Income Statement) → Equity (bal sheet)

Asset (Total) : 1583995
Liab (Total) : 58966
Capital stock : 500K
950K
Add. paid in cap : 75K
Retained earn : 16.5K
Acc. other inc : −7.5K
Foreign curr (loss) : −3971.12
Treasury stock (less) : −5K
1525028.88

eg: Foreign Currency transactions
(Any gain/loss in this category)
Unrealized gain/loss : Investments, pension, derivatives/assets

4. Income & cash flow : chapter 10 : (P&L)

Single step format

multiple step format
(preferred: more info)
(publicly trading companies)

Net sales : Gross sales − Gross returns allowance

Net income : Net sales − all expenses

Single step format

net sales :	150K
COGS :	72.5K
Selling, gen, admin exp :	45.3K
Interest expense :	200
other income :	310
Income before taxes :	32 310.
provision : IT :	4847
Net income	27464
Earning per common stock	3.45 (Bottom line)

multi-step format

net sales :	150K
COGS :	72.5K
gross profit	77.5K
selling... exp :	45.3K
Inc from ops	32.2K
other inc (expense)	
Interest expense	200
other income	310
Inc before tax	32.31K
Prov Tax	4.847K
Net inc	27,464
earning	3.45.

single step: No line items

multi step: Line items like gross profit, gross income from operations

(Ratio analysis: useful) others income and expense!

Business: Service, manufacturing, merchandising

→ from scratch (Raw, worken progress, completed)

→ Retail (target, sale), Inventory

→ Not tangible (Accountant, attorney, hair stylist, CPA (not paid for paper: But skill)

Lack of inventory (Not primary atleast)

---

why Revenue & expense: seperated:

* Isolate problems to make decision
* Heading: Name of the company
* Then type of report (Income statement)
* Then period covered (For the year ending Dec 31 2023): Not the date report prepared!

Revenue: (Gross sales, others income)

1. Gross sales: By selling business (Invoices)

   * Gross sales / gross receipts : Account
   * Revenue before any deductions from revenue

     Implicit contract: shopping mall: Buy, give cash!

     written contract: contract for sale (state expenses, obligations of both side)

2. Others income/loss: sell car/asset

Revenue: when earned (satisfy contract) : earned

expect to be paid (realizable), Bankrupt: not realizable

Account Receivable: Revenue not yet paid

Others income: Interest, Dividend, sell assets

GAAP: Others income: only appear later! (not significant as sales!)

Contra revenue accounts:

* Revenue accounts normally carry a credit balance.
* Contra: Contradictory to normal balance
* eg: Sales discounts & Sales returns and allowances

↳ paid early (give discount)
2% if within 7 days
2% Net 30 → 7days

↳ No longer want & return: get total (amount + tax))

Sales returns

Sales allowance: Discount for dent/damaged products.

$\boxed{\text{Gross sales} - \text{Sales returns \& allowance} - \text{Sales discount} = \text{Net Sales}}$

Net Sales: Total (not an account in chart of accounts)

* Net sales: mentioned with/without line items (gross Sales, Sales disc...)

CoGS:

* Direct cost to sell a product (Service Company: no CoGS)
* merchandisers (easy to calculate): CoGS, easy to track!
* manufacturers: little trickier!

merchandising CoGS:

* Beginning inventory (Before Jan 1 say: Before purchasing left overs)

purchases: Buy during current method

Freight in: shipping expense to move!

Net purchases = CoGS − Contra (purchase discount, purchase returns & allowances) − Ending inventory (yet to sale)

Revenue: Credit
purchase: Debit

$\boxed{\text{Beg Inv} + \text{Net purchase} = \text{CoGS} - \text{Ending Inventory}}$

End Inv: 10K
Beg Inv: 5K
purchase: 123K
CoGS = 123 + 5 − 10

$\boxed{\text{CoGS} = 118\text{K}}$

Manufacturing CoGS:

Beg Inv + Cost of goods manufactured = Cost of good available for sales

$\boxed{\text{CoGS} : \text{CoG available for sales} - \text{Ending Inventory}}$

Prepare CoGS line items:

* Direct labour : pay for workers (manufacture)
* Factory overhead (exclude cost in direct material & direct labor)
    * Indirect material : Thread (used for various garments)
        ↳ Blouse Company : Indirect material
    * Indirect labor : Quality Controlling officer
    * Depreciation of equipments
    * Utilities : A.C, Heating, Light, power to run machines, water (not tied to a particular product : unless company makes only 1 product)

Purchase part

Beg Inv	:	5K
Net purchase	:	134K
CoGs avail for sale	:	139 K
Direct material (ending), ending direct inventory	:	-7K
Direct material used		132K
Direct labor		57K
Item factory overhead		
Depreciation : 6K		
Utility : 14K		
Indirect factory labor : 82K		
Indirect material : 4K		
other overhead : 500		107K
Manufacturing cost incurred :		297K
Beg work in progress		75K
end work in progress		84K
CoGs manufactured		288K

Gross profit :

* left : subs CoGs from sales
* money after expenses (direct)
* Money before other expenses
    1. office rent
    2. Salary...

Higher gross profit : Good!
(But expenses (other) need to be in line)

operating expense :

1. selling expense (staff, commission for sales, ads, supplies, depreciation : equip, furniture) : cash register, display case, racks
2. General, admin expense
    1. office supply, payroll
    2. Non factory rent
    3. Accounting, Legal service

* Bottom line: made profit / loss
* operating income: Gross profit - operating expense

(Sales - CoGS) = operating income

* others income & expense: (gross sales: only business money). (Others: Interest,

Why Interest not an operating expenses:

* Borrowed money for business operations (why interest ~~exp~~ expensed as op expense)
* operating exp: day to day activity (As per GAAP: interest expense no!) unless business lends money.

Income from continuing operations before taxes:

Income before taxes →

Gross Income (Sales) - CoGS = operating Income

Continuing operation Income (before tax) = op inc - others inc/exp

↳ why? (say Company has no profit/loss): So just income before taxes!

Provision for income taxes:

* Reduce provision for income tax from Inc before taxes! (Federal / State income tax)

Inc from Continuing op: 25 K

IT: 35% (9K)

Inc after tax: 16K (appr)

Net Income = (No unusual operations / dis continued op)

Inc from Continued op - Taxes (Inc before tax)

Income - all expenses - Taxes

Earnings per share:

* Net income / no. of outstanding share (eg: what % dividend paid from net income (net earnings per share)!

Common stock: Ultimate owners with voting

Preferred stock: Gives claim to asset (first settle them if closed, before common stock holders, No voting rights) → exclusive dividend! (get ple first)

* $1 per Common Stock, $4.5 per preferred Stock
(Announced by company)

* preferred Stock has higher claim on assets
after bond holders & creditors!

Net Inc : 473K
38K Shares, 4.5 per Share
↳ preferred
205K Shares Common
38K @ 4.5

Unusual Income Statement Items:

* GAAP requires : Unusual / unfrequent / both : report seperately from operating
Contuing income operations

* Disclose nature, effect!

qualifiers
1. High degree of abnormality
2. Unrelated / incident related (not day to day)

Accountant's Job :

* Look facts, Circumstances, evaluate event
↳ If it may happen again : Unusual! (Book it)

* Broken out (Seperated) from Continuing operations (Better idea)
↳ Frequent & infrequent events!

Discontinued operations :

* Segment of a business : held for sale (legal obligation : Share holders voted)
↳ Immediate sell
Active plan : unlikely to change
Expected within a year!

* Financial accounting dictates
1. Any loss selling (tennis shoe segment (net of tax) : anticipated,
loss / gain incurs during selling (net of tax)
↳ Include on income statement

eg:

Inc from Continued operations : 75K
Loss from descont op (net of tax) : (13K) : After tax calculations
Cumulative change in Acc principles : (8K)
54K
Net income
Net inc attributable to non-controlling interest (4K)
50K
Net inc attributable to parent

200K (Sold), Bought : 150K
Net of Tax : 50K - 10K
(gross profit - capital gain tax)

earnings per share : 3$

Before 2018: Extraordinary events: report seperately from operating income.

US GAAP now: Include with GAAP!

Non Controlling Subsidiary Interests:

* only parent's equity in the subsidiary company is included in the bottom line.

Company: differs how they manage accounts
GAAP : Doesn't change how income statement looks on paper

when: unusual events (not present): preferred to use net income instead of 'income from continuing operations'

ABC manufacturing company
Income Statement
For the fin year ending Dec 31 2023

Sales:

Sales		390K
Sales disc	27800	
Sales returns, allow	1200	29K
Net sales		361K
COGS		291802
Gross profit		69198
operating exp:		
Selling exp		
Sales salary	4500	
Commission	1895	
ad	750	7145
General, admin exp		
office salary	10K	
Supply	1560	
Insurance	9K	
Utility	5230	25790
Total op exp		-32935
Operation Income:		36263
other income		
Interest	2500	
Dividend	2875	5375

		5375
other expense		
	Interest	– 1326
		40312
Inc before taxes		
provision for IT		– 14109
		26203
	Net income	
	Earnings per share	2.62

* 10k Common Shares, no preferred.
** Assume 35% tax rate

---

profession Income Statement: Show CoGS: Single line item

why? Don't care except bottom line figures!

write up service: Check check, Bank deposit: Do adjustments in AR, AP! (Small business)

Cash flow: Chapter 11

* Health, Cash payments, receipts: Cash Statement of cash flow!
* operating, Investing, Financing
* 2 ways (acceptable): Direct, Indirect
* FASB prefers direct method (provides users more standardized info + accurate)
* most Companies: Indirect method (cost effective)!

All cost: not expense (until recorded in Income Statement)

* Profit: Real net income (not yet collected/paid)
* Cost ≠ expenses
  * company buys a car (25K: cost (promise/agreed to pay))
  * Depreciation: reclassify into income statement (expense)
  * 25K spent but only 4.5K as expense: Year 1 ⟶ difference huge!

Cost: value of money (Buy): Not available to use

Expenses: Costs directly tied to revenue (earned) in a fin year

Why Cash flow:

* Show Cash source, uses : cx payment, loans, sale of asset, equity
* Need for external users : how wisely spent/managed.
* Can repeat gain? Enough cash to pay loan/dividend? healthy (why net income, Cash transactions difference?)

operating : Revenue, expense, cash rec from gain/loss on income statement, cash paid out for other costs.

Investing: Debt, equity : inv purchase, sales : property, plant, equipment + principal debt

Financing: short & long term debts, equities

GAAP operating results (what should appear):

* Income statement items (simply)
* Cash sources (Receipts (invoices), Trading portfolio sales (short term)

Why short term trading : highly liquid (bonds, loans, stocks) : won't go down (near future)

$\boxed{\text{Short term: operational}}$

* Interest & dividends (loan to shareholder/employee), To vendors,
* Cash outflows : Acc payable (payment made)
  Short term trading portfolio purchase
  payments for other business expense
  (inventory, pay: employees, utility, tax)
  Interest payments

$\boxed{\text{payment of dividend (not business expense)! won't appear on income statement! so not an operational expense on cash flow! (won't appear on operational cash)}}$

Investment transaction:

* sale/buy: non current assets (> 1 yr) : past the date of balance sheet
  * Common stock : equity investment (no relation with company)
  * Bonds : debt investment!

Investing source of cash: → Long term (sell/generate revenue)

* Loans given, matured bonds/investment
* Sale debt portfolios (not the above 2)
* Sale of equity investment, PPE

Investing use of cash:

* Loan, debt purchases, equity, PPE (purchase)

$\boxed{\begin{array}{l}\text{Source of cash: invoice, short term trading interest, dividends} \\ \text{Use of cash: pay vendors, short term buy, business expenses, pay interest} \\ \text{Cash investment: equity, debt}\end{array}}$

Financing activities: Long term liability/equity items (Issue bond/stock)

Operation	Investing	Financing
Source: * Invoice & cash receipts * Short term trading portfolios (stock, bond, loans) sales * Investment & dividend	* Long term asset sale/collection (loans, bonds, sale debt invest) * Sale of equity investment * Sale of property, plant, equip, Intangibles	* Treasury/sell: stocks (own) * Sell loans (or) bonds (or) buy loans * "Financing"!
Uses: * Satisfy AP (pay Bills) * Short term trading portfolio buy * payment for business expense (Inventory, pay emp, Income tax, supply) * Interest payments (operating capital loan/any form) irrespective of purpose eg: vehicle financing loan interest paid same as capital loan!	**Uses:** * pay loan/debt purchase * purchase equity investment * purchase PP&E	**Uses:** * Treasury stock (Buy own equity) * Cash dividend pay * pay back debt

2 methods: Direct & Indirect

* FASB prefers direct
* most company: Indirect

] Both same cash balance in bottom line!

Private: can use any methods FASB: standardize, reduce diversity

Direct method:

* show net cash from operating activities (All invoice payments, Bill payments)
* All payments & receipts (cash): cx payments, dividend received, sell asset...

1. Present cash received: Not net income/loss
2. Only difference: operating section
3. Direct method: FASB preferred!

* Indirect method: Start with net income from income statement
Reduce non-cash items, depreciation, Ammortization, expense(noncash)
Reduce gain/loss from selling assets (Net book value = Book value - depreciation)
↳ Net book value - Selling value.

Sold: 1.5K
Bought: 3K
Depreciated: 2K
500: gain → 500 difference b/w Gain on income statement & cash inflow.
Cash inflow: 1.5K

+ve/-ve cash flow: Covers up expenses by operating funds rather than borrow/selling!
(Not a continuing event)
else: Debt (pay back ever): Bad

Investor: Dividend, Gain in price
Creditor: pay back debt!

Direct method

Statement of Cash flow
Direct method
For the year ending 12/31/2021

Cash flows from operating income :

Cash from cx	: 75,523
Cash paid to suppliers	: (5546)
Employee compensation	: (6763)
Other expenses paid	: (1859)
Interest paid	: (675)
Taxes paid	: (990)
Net cash from op act	: 59690

Cash from Investing activities :

Sale of equip :	15K
Land purchase :	(65K)
Net cash Inv act :	(50K)

Cash flow from financing activities :

New long term borrowing	: 1485
Pay long term debt	: (575)
Purchase treasury stock	: (300)
Pay dividends	: (450)
Net cash from fin act :	160

Increase (dec) in cash : 9850
Cash bal (Jan 2021) : 75620
Cash bal (Dec 31 2021) : 85470.

Reconciliation of net income & net cash provided by op act

Net income : 57183
Add/sub non cash items :
Depreciation : 2580
Gain (Sale of eq) : (623)

Increase in AR : (2575)

Increase in AP : 3125

Net cash by op act: 59690

Indirect method

Statement of Cash flows

For the year ending 12/31/2021

Cash flow from operative activities:

Net Income	57183
Add/ded : non cash items:	
Dep	2580
Gain/loss equip sell	(623)
Inc in AR	(2575)
Inc in AP	3125
Net cash flow by	59690

Same : Inv

Same : Financial.

Inc in cash : 9850

cash bal Jan 1 2012 : 75620

Cash bal Dec 31 2012 : 65470.

Note : Direct method : Need to mention reconciliation section!

Reconciliation : Same as indirect method!

Same cash flow: Regardless of method

Depreciation cash flow assumptions

* Tangible asset (Fixed : PPE) : Depreciate (how long used)
* Connect business cost to expense (Balance Sheet ⟶ P&L)
* methods: Straight line, declining balance, Sum of the years - digits, Units of production

Intangible assets (can't touch/see) : Ammortization !

* Depreciation : Allocate Company's cost to the appropriate accounting period.
  Not used to calculate fair market value (Depreciate assets they own)
  Non cash transaction
  Affects more than 1 financial statements (Balance sheet, Income statement) cash flow.

Anticipate (able to use > 1 years)! (Asset)

* GAAP : dictates purchase can't be used to deduct income all at once
* Capitalization : Record a purchase (cost of an asset) to Balance Sheet

Balance sheet : purchase goes on B.S.

Income statement : Eventuall move from B.S to Income Statement

Cash flow :

* purchase : Entire cost goes to Cash flow (non-cash : still record : different)
  Depreciation : Add back to cash flow (if used indirect method)
  ↳ why? Income statement : recorded as expense (non-cash)!

$\boxed{\text{'Add back'}}$

what items has to be capitalized (Common Sense)

* Trash can (> 3yrs used) : capitalize? [unless fancy lot of cost]
* most Company : Capitalization policy : Dollar limit (> 100 $)

Costs :

* cost and expense : promise cash / pay cash (pay cash/credit card)
* Business world : cost, expense ⟶ Different!
* Day to day costs different from expenses
  ↳ Future cost will turn to expense!
  ↳ exchange cash/promise cash : purchase good/service (generate revenue)

$\boxed{\text{'All expenses have to be matched with revenue for the financial period'}}$

Revenue − Expense = net income

* Buy machines : Cost
* Use (Yearwise) : depreciate (expense)

Resource used	: cost (Balance sheet)
Expense	: Income statement

Matching principle:

* Associate all recognized revenue (earned, realizable) to all expenses incur
* \$1500: expense at purchase ⟶ Reduces net income (Understated)

Next 4yr (assume 5yr) ⟶ overstated

∴ \$1500: used for 5 yrs (anticipated): So not a single accounting period!

Split for 5 accounting periods: depreciation!

product & period Cost:

* Costs (GAAP): Product, Period, Systematic
* Systematic: expense over time (depreciation) Cost.
* product cost: Cost to manufacture/merchandize (Buy/produce)
* period Costs: cost necessary to make the business doors open (not tied to inventory: eg: Rent, Telephone expense, Salaries)

which costs are depreciated:

* Fixed asset: Computer, machine (Spread useful life): Systematic cost
* Logically allocate cost over period.
* Tax + shipping charge (Fixed asset): GAAP (must record on the

Balance sheet: original cost + All necessary costs) to make the asset ready to use!

$\boxed{\text{Total Cost} = \text{Depreciable base}}$

Total Cost ⟶ original

⟶ Tax

⟶ Freight in (ship)

⟶ Assembly.

Allocate cost b/w land & building:

* Best practice: Do appraisal on purchasing process (Licensed person)
* Appraisal to assure mortage Company (worth, not over valued loan)
* make sure allocation of building to land (If allocation: Just for property tax purposes: It may not be materially correct for depreciation purposes)

$\boxed{\text{Total Value} - \text{Land cost}}$

Real property depreciation: (Land, Building: Both fixed assets)

* Cost of land: not depreciated + seperate from building cost!
* GAAP mandates it! Land improvements are depreciable (fence, road, gate)
* Simple: when bought land, built building
* Any cost clear/level existing building: adds to land not building (Not depreciable)
* Cost of landscaping: period cost (expense in the Accounting period)
* Repair, maintenance: expense of the period (not systematic cost)
*

Land price:	500K
Landscape Cost:	10K
Level land:	0.8K
Cost to use land:	510.8K

→ Not depreciable (Recorded in balance sheet in land account)

Pedestrian walkways: 35K → Depreciable (has useful life time): Land improvement (Balance Sheet)

Gardening: 200 monthly → Expense!

Refurbish asset (↑ life time): Add to net book value

Net book value = book value (cost) − acc. depreciation

Depreciation methods

1. Straight line: evenly for 4 yrs
2. Declining balance method: Accelerated (higher in early years)
3. Sum of the years digit method: $3+2+1=6$ (3yrs usage)

Year 1 $= \frac{3}{6} = \frac{1}{2}$

Year 2 $: \frac{2}{6} = \frac{1}{3}$

Year 3 $: \frac{1}{6} = \frac{1}{6}$.

→ 100 → 50 33.33 12.22...

4. Units of production method: Compare estimated no. of units: fixed asset will produce!

Depletion: Annual expense for the use of natural resources (oil, timber, minerals)

Asset cost, life time, value of asset after life time

* choose appropriate method for an asset (can't change): match expense to revenue
* Date: when the asset is ready for use not purchased date!
* Basket purchase: number of assets in a single purchase
* Allocate Cost: Based on appraisal | fair value (market value)

Straight line method:

* 30K/5yrs : expense 6K each year! (35K: bought, Salvage value = 5K) → Retire value!

Accelerating: Declining balance:

* Double declining balance (twice the straight line rate)
* 5yrs : $\frac{1}{5}$: 20% ⟶ 40% (taken)
* Limit the depreciation to salvage value (No matter what the rate is at year 5)

		Dep. value	Net book value
Y1: 30K ⟶	40% ⟶	12K ⟶	18K
18K ⟶	40% ⟶	7.2K ⟶	10.8K
10.8K ⟶	40% ⟶	4320 ⟶	6480
6480 ⟶	40% ⟶	2592 ⟶	3888
3888 ⟶	* ⟶	888 ⟶	3K

3K: Residual/ Salvage value

Sum of years digit:

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

yr1: $\frac{27K}{3} = 9K$ $\left[\frac{5}{15} = \frac{1}{3}\right]$

: $\frac{27 \times 4}{15} = 7200$

: $\frac{27 \times 3}{15}$

: $\frac{27 \times 2}{15}$

: $\frac{27}{15}$

Sum = 27K

Usage of units of production:

* Good for machinery, vehicles

* 50K miles, 30K (value), Salvage: 3K [27K/50miles = 0.54 per mile]*

* Standard mileage rate assumed!

$\boxed{\text{Yr 1: 10.2K miles} \longrightarrow 10200 \times 0.54 = 5508 \text{ (depreciated)}}$

* Year 5 end: 27K (no matter of method)
* Use method expense: fairly the value of asset over time!

Difference:

S.L	Double dec	Sum of dy	Units of prod	
5.4	12	9K	6102 →	11300 miles
5.4	7.2	7.2K	5508 →	10200
5.4	4.32	5.4K	5130 →	9500
5.4	2592	3.6K	4698 →	8700
5.4	888	1.8K	5562 →	11100

27K

Reduce Tax income by using depreciation!

Buy mid year (Fixed asset):

* June 1 → 10/12 (10 months remaining in fiscal year)

2/12 → done in 6 th year!

Depreciation schedule:

* Description
* Purchase + additions
* Life
* purchased date
* Current depriciation
* Accumulated depreciation
* Net book value

→ [Company size]
Identification number
property tax info
other fact

Des	Cost	Life	method	Salvage value	Pur date	Current yr dep exp	Acc dep	Net Book value
Van	30K	5	Units of pro	27K	:	3060	6200	23800
Comp	1.5K	3	SL	0	:	500	1000	500
Furni	2.5K	3	SL	300	,	733	1466	1034
Fixtures	700	10	SL	100	.	60	240	460.

GAAP (VS) Tax depriciation:

* Double depreciation: Allowed by GAAP (tax return purpose) (IF)

Section 179
Special expensing for assets < 2500 dollars → IRS!

* Section 179: Expense asset purchase (< 25K), 2021: Limit 1M!

* Smaller purchases (< 2500): Expense!

Chapter: 13: Learning about inventory cost flow assumptions

* 2 methods: value inventory

* 4 methods: Calculate ending inventory: Specific identification
weighted average
LIFO
FIFO

Inventory valuation:

* manufacturing/merchandise: Inventory (largest asset)

* which cost go on to balance sheet, which to P&L

* Inventory ties in to the revenue process & to cost of goods sold

* match expenses with revenue: GAAP

* product costs: part of the cost of goods sold.

(Relate inventory: Cost that company incurs when purchase/ manufacturing an item for sale).

* Cost of goods sold: (on income statement): Is what company pays to sell a product to the customer (specific period).

↳ Rest stays on balance sheet (current asset)

Inventory: ↑ when purchasing
Inventory: ↓ (selling), COGS: Cost spent to sell that item (current asset)

Service Companies: If large amount of office supplies on hand: Inventory them instead of just cost of supplies purchased (To expense each month)

Purchase: Supplies on account: (AP) 1000
Inventory : 1000

Used: Supplies expense (Income statement account): 350.
Inventory: 350

*Some retail shop (shop supplies): bags, tagh, cash register receipts to expense accounts instead of inventory!

★ Normally not a big deal unless the expense is a material amount!

Larger retail: Not correct!

Inventory classification:

★ merchandise: only 1 class of inventory

Purchase: Inventory (debit) | Use: Inventory (credit)
A.P (credit) | COGS (debit)

Balance sheet!

Keystone: 100% markup

★ Merchandise Inventory systems:

1. perpetual: (electronic cash register/self checkout): Instant
2. periodic: only updated periodically

Perpetual:

* pos/electronic cash register/self checkout: record sale: update Inv, COGS,
★ eg: Amazon (only 5 left): cross check inventory (still good practice)

Periodic:

* physical inventory taken periodically: Adjust Balance sheet (Inv asset)
* Take ending inventory! (Not up to date, easy)!
* If physical inv: not taken (uses estimate of prior months)

Gross profit method

* Not officially own (Consignment): won't included in inventory! (Keeps track)!

Manufacturing Company:

* Account all expenses while making: has COGM (manufactured)
* Direct material inventory: Raw material (perpetual/periodic)
* Work in process: (Semi finished/Yet to assemble)!
* Finished goods inventory: Ready for sale

Buyer (In transit):

Free on board shipping point: Cx owns from docking
Free on board destination: only after its loading dock
↳ "still part of inventory"

Inventory valuation:

* Specific identification, weighted average, FIFO, LIFO. : must be in footnotes

Specific identification: * exact cost of each product (Serial number): Art gallery

Weighted average:

* Avg cost of all units purchased: Used when inventory substantially same
* Grains, fules

FIFO: Sell oldest items first (By paper)

LIFO: Last first (By paper) ⟶ popular: As closely matches expenses to revenue (Dollar to dollar value)

when LIFO used: Have to include LIFO reserve amount in notes section [difference b/w using FIFO & LIFO]: ending inventory

Comparison: weighted average: Inflation/deflation: more difference! (Fall b/w LIFO and FIFO inventory ending)

	value of ending	FIFO	LIFO
Inflation	Inventory	High	Low
	COGS	Low	High
	Net income	High	Low
Deflation	E.I	Low	High
	COGS	High	Low
	N.I	Low	High

* Inflation: price ↑ (FIFO: COGS lower, Inventory value high, Net income: High)
↓
Less COGS (expense)

Inflation: Good to use LIFO (Tax purpose) Deflation: FIFO (Tax purpose)

LIFO liquidation layers:

* Changes in the no. of items in ending inventory combined with fluctuations in cost per item affect COGS and net income.
* Using LIFO: Closely match expense to revenue (As within 45 days sold)
* When inventory levels rise: additional valuation done & eventually moved to COGS.

1. Diff b/w LIFO & FIFO ending inventory
2. Inflation: LIFO higher cost of COGS than FIFO
3. LIFO closely matches revenue to COGS than FIFO.

Weighted average:

* Total = 13250, no. of shoes = 1248 (10.62 per unit)
* 2nd quarter: 710 pairs sold (7540)
* Ending inventory = 5710

* 1000 shoes: @ 10 (weight) * 100 sold @ 10 * Ending: 9000 * purchase: 1000 @ 9 * 9000 + 9000 = 18000 * 18000/1900 = 9.47 (each)

Inventory work sheet:

Item name	Description	Qty	Actual Count

* Perpetual: year end do verify (theft / damage)
* Journal entry to prepare theft / missing / damaged! (Under GAAP)

Chapter: 14: Ratios & other tools

Liquidity

Profitability

Activity (generate sales by using assets)

Liquidity:

* Free cash to meet its obligations → Lagging receivables (some time discount / Finance company (pay to receive fast)!
  → Increasing inventory
* Bad: pay rent to store more by buying in discount!
* Accounts (measure liquidity): Taken from the balance sheet.
  ↳ current accounts!
* Liquidity: Short term (not common to create trend analysis)

1. Current ratio
2. Acid test ratio
3. Working capital

Current ratio:

* $\frac{\text{Current asset (AR, Cash, merchandise inventory, short term investment)}}{\text{Current liability (AP, Accured pay roll, short term debt)}}$
* How liquid a company is? able to handle short term obligations
* Inventory valuation affects: inventory → current ratio!

Acid test:

* Current ratio has inventory (not always easy to convert to cash)
* Evaluates worst case scenario: can't sell any existing inventory, can it pay bills?
* $\frac{\text{Cash + Investment (short term) + AR}}{\text{Current liabilities}}$: $\frac{120000 - 40000 (Inv)}{57000} = 1.4$
* Current ratio ≥ 2.0, Acid test ratio ≥ 1.0 : Enough liquidity!
* If lesser: see trend analysis (Decide)!

Working capital:

* Current Asset − current liability (low: capital loan, short term loan)
* many business cover short term debts: by selling & collecting AR.
* not a ratio: dollar amount!
* working capital: never affected by paying short term debt!

why: Current asset ↓, Current liability ↑ (same amount)
↳ (But affects current ratio):

Profitability: (In addition to how well a company covers its current debt with current assets: must evaluate robustness of income over years)

$$\boxed{\text{Profitability index} = \frac{\text{Expected cash flow}}{\text{Potential investment}}}$$ over different assets

Trend analysis: * Single year (unable to judge) → unexpectionally good / bad year
→ under gaap (different inv methods)

* more helpful : over years!
* How going up & down (Company with companies)
* Single year: Can't decide
* Historic value ; won't change! Consistent!

RoI (Return on Investment):

* Tool : investors : how well performing (Buy / Sell)
* How well Company management uses my money : Competancy, profitability
* Expressed in % (Income to assets)

$$\frac{\text{Net income (bottom line)}}{\text{Average total asset (opening+closing/2)}}$$ | $$\frac{\text{Operating income (Inc before tax, interest)}}{\text{Average operating asset (PPE)}}$$

Dupont model (expanding on RoI):

* Developed in the late 1930s : Calculate RoI by mul margin by turnover
* $\text{margin} = \frac{\text{Net income}}{\text{sales}}$ $\text{turnover} = \frac{\text{Sales}}{\text{avg assets}}$

RoI using $\boxed{\text{Dupont} = 7.4 \times 1.6 = 11.8\%}$

'As long as consistent, calculating RoI with any method : good'

Return on equity:

* profit earned for each dollar invested in a Company's stock.
* $\frac{\text{Net income}}{\text{Avg owners equity (left over after asset - liability)}}$
* Higher RoE ratio : efficient management! (how effectively investment is used)

Activity measures:

* Company's asset & sales relation. (AR and inventory)
* How well assets are used to make money (expansion of RoI)
* Asset turnover analysis : how quickly asset comes in & out

$$\boxed{\frac{\text{Net sales}}{\text{Avg total assets}}}$$ quicker the better!

* A.R turnover = Average no. of times AR turned over (Booked & paid)
* Sooner collects payment : Better! (else: borrow)
* Credit sales = 35K, AR (Jan 1): 2.5K, AR (Dec 31): 1.5K $\left(\frac{35K}{\left(\frac{2.5+1.5}{2}\right)}\right) = 17.5$

* Average collection period for AR = Avg no. of days credit sales remain in AR (Set credit policies, collection policies)

$$\frac{\text{AR (as of last day of fin year)}}{\text{Avg day's sales (all sales/365)}}$$

Inventory turnover:

* how efficiently handling inventory (less on hand: lower cost to store)
* Imp: out of inventory (not a good thing): may pay higher (instant stock)

$$\frac{\text{Sales}}{\text{Avg inventory value}} = \frac{35K}{8.5K} = 4.12 \text{ times}$$

* Some use COGS instead of sales for inventory turnover (paid not credit)

Number of days sales in AR:

* quick collection: Better cash flow (Avg collection period for AR / no. of days sales outstanding)

* 2021 sales (330K, AR: 45K)

$$\text{Per day sales}: \frac{330K}{365} = 902.90$$

$$\frac{AR}{\text{Avg day sales}} = \frac{45K}{902.90} = 48 \text{days}$$

(Good, leave
Bad: Action to collect fast)

Analyze: Fin. statements: (horizontal, vertical):

* Compare income statement accounts to each other in dollars & in %
* Useful to internal users (analysts): manage staff, Reasons?

Horizontal analysis: Accounts over different period
How much changed: good / bad!

Net income (% of sales)
2020: 6.39
2021: 5.18

	2020	2021	% change
Sales	510K	495 K	-2.94%
Gross profit	272 K	276 K	1.83%

↑ in CoGS: more investigation (why? Increase in CoGS)

vertical analysis:

* Compare all other accounts to sales
* Heads up: If CoGS/any expense too high compared to sales
* Isolate problems & solve

* Difference gross profit & net income % year by year
* ↑ in CoGS, offset by ↓ in wages (owner pay cut) : Bottom line difference low

	2020	2021
Sales	100%	100%
CoGS	53.33%	55.95%
Gross profit	46.67	44.05
wages	32.94	31.26
Repair	1.01	1.16
⋮		
Net income	6.39%	5.18%

horizontal

* Same type of analyze for balance accounts
* Compare like accounts to each other over periods of time (AR)

vertical

* Account of interest (merchandise inventory as % of total assets)

Common Size Financial statements:

* visually zero in (1 way) potential problems & missteps within a business

is to prepare & study common size financial statements.

* Get rid of dollars & cents : Reflect account balances as %
* eg: vertical analysis: all income statement accounts in % of total revenue

$\boxed{\text{omit dollar (references)}}$ → Take dollar's distraction away.

* Compare companies, Just higher income doesn't mean anything simply.

$\boxed{\text{\% of another account: meaningful}}$ → Takes effort, tedious

eg:

Charlie: 200K (takehome)
110% Living expense
Reason: Spend more

Frugal: 75K
65% ⟶ more chance of paid back (Frugal)!

Chap 15: Reading explanatory notes & disclosures

★ 4 characteristic of a Corporation : Continuity, easy transferability of shares, Centralized management, (Biggie) : Low/limited liability.

How Corporates should govern themselves:

★ Corporate governance : framework under which a corp must operate

★ Establish financial control (policy, procedures), show accountability to share holders, Act best interest of S.H & Community (operates).

★ Disclose full info (self regulation) ⟶ Best interest of S.H (RoI, effective opera).

Sensitive to environment!

Corporation characteristics:

★ Incorporation : Turn regular old business to corp (governed by state statute) play rules of the state where it operates

★ Enron (worst):

★ main problem: mark to market accounting (Book before earned)

★ eg: sell machine, Book when Contract is signed (not when sold)

★ ↑ Cash flow (Based on guess) ★ → Stock options

★ Higher employees: offered incentives at Public Trading Comp

★ Higher profit : price goes up ↑ (Beat projections)

★ go up ↑, stock options : also up ↑

★ Theory : profits booked (not in practice)

many lost savings, insurance (tied to enron stock), lost jobs!

★ Incorporation : articles signed with state secretary, name, address, info, type, no. of stocks, Registered agent (to question)! New share holders elect directors.

$\boxed{\text{IPO: offers to public}}$

4 characteristics:

★ Limited liability : Corp sued by vendor : investors faces problems

Exception: Certain unpaid taxes (given to shareholders : FICA, medicare).

★ Easy transferability of shares : closely (not needed), public (must)! ⟶ No permission

★ Centralized management : not divided, efficient (oversee day to day)

★ Continuity : (until fully dissolved) : members can change, officers, S.H

↳ Corp rolls on!

Common explanatory notes:

* Discussions of accompanying items (important disclosures) not included in statements. (Foot notes/note : Term)
* why: Fulfill the needs of the external users (Company Complied with reporting or taxation issues)
* explain how/why a company handles a transaction
* Full disclosure : level playing field ! Compare fin stat : companies
* Financial/non financial info about the company's operation.

Order: Notes for Income Statement first
Then Balance Sheet
Then Cash flow

1. Explaining significant accounting policies:

* Some breaks Business, accounting policies in to seperate notes
* 1. Basis for presentation 2. Accounting policies
* Alternatively (single note): summary of significant accounting policies lists basis for presentation first.

* Helps better interpret statements (footnote: for each policy choice)
* usually deprication method : Included (basis : IT/employee benefits)

1. Reviewing depreciation & inventory valuation methods:

* opt to use : for fair Comparison (footnote)
* methods for recognizing depreciation/inventory: mentioned in note 1

eg: 1

Note 1 Summary of business & accounting policies

we compute using FIFO. The valuation of inventory revalues we estimate the value of obsolete/damaged inventory

PPE record at historic costs. compute depriciation using S.L (2-5yrs)

↳ 'paid in/debt' cost

2. Consolidating Financial Statements:

* when Companies merge/acquires : aggregate 2/more companies
* In footnote : Confirm the fact : consolidated (subsidiaries)
* Disclose deviation, say 60% holding (must Consolidately report)

Note 1: Summ of Business & Acc policies

our consolidated fin stat : parent + all subsidiaries. Intercompany trans eliminated. we use equity method (ownership proportion : stock)

4. Account for income taxes:

* Diff b/w GAAP & tax purpose fin statements
  - ↳ Book accounting
  - ↳ Tax accounting

* Temp / permanent difference: GAAP: Entertainment cost: 100% expense
  Tax acc: 50% ! (IRS tax code)

* Temporary: Book purpose: Use S.L depreciation
  Tax purpose: Use accelerated method.

must address book & tax difference: Deferred tax assets & liabilites in fin note.

Note 15: Taxes

2021: Income before tax 7.68m, 2.78m (Federal tax: 21.1%)

Deferred income taxes reflect the net tax effect of temp diffs: (asset & liability) .. reporting for fin reporting (vs) Tax reporting purpose!

5. Spell out employee benefits:

* Company's expense, unpaid liabilites for employees: Retirement / pension plans
* Obligation: health, medical cost

Note 18: Retirement benefit plans

Tax-qualified profit sharing retirement plan (current, former, retired): As of Nov 2021, 80% settled, some 20% invested using external investment managers.

6. Walking through intangibles:

* patents, licenses, designs, trademarks: signs, symbols, names
* Explain intangible assets in explanatory note (how it has determined the intangible asset's value showing on the balance sheet.

Note 14. Intangible assets

Classified with other long-term assets. Dec 31 2021: our intangible assets has patents, copyrights, goodwill. Generally amortized using S.L method. Yearly review: calc. lifetime

7. Event disclosures:

★ Annual report (Info): Accounting changes, business combinations, Contingencies, events happening after the balance sheet date, segment reporting.

★ Goes in footnotes along with acc. method.

Accounting changes: Principle change, accounting estimate, reporting entity.

Narrative description goes in explanatory notes (1/2nd note)

1. Accounting principle: (guide to record acc. transactions)
   Depreciation method (change principle: preferably / enforced by GAAP)
   change: Show all affected prior periods (unless practical)
   1. Adjust carrying amount (asset, liability change)
   2. offset to retained earnings
   3. ~~If~~ trend analysis: show effect in each reported years

2. Accounting estimates: Best guess to certain transaction (salvage value)
   Lifetime
   Any change: recognise currently (re calculate: current & future financial statements): No change to prior statements.

3. Reporting entities: What combinations of businesses are shown combined on fin stat.
   (consolidated fin. statements)
   Comp A owns 50% of B (parent), B is a A's subsidiary
   Something changes in the way subsidiaries shows up (change in reporting entity)

   Show dollar amount effect of the change of reporting entities in the balances of all related assets & liabilities

   Any offset ⟶ Retained earnings.

Business Combinations:
- ⟶ merger (friendly not hostile takeovers)
- ⟶ Acquisitions (Target cease to exist); Not friendly as merge
- ⟶ Dispositions: Transfer / sell / get rid of business / division!

$\boxed{\text{explain, if effect on statements (explanatory notes: very early)}}$

⟶ 1/2nd note: addressed as needed in subsequent notes.

GAAP (disposition):

★ Facts, Circumstances + Anticipated of gain/loss (net of tax)

⟶ Also show on P&L

Results pulled out & reported seperately (AS Cease to exist)

Contingencies:

* existing circumstance: cause loss in future (indeed / never) : IT dispute
* Irrespective of favor / not : must report

Note 10: Commitments & Contingencies

As of Dec31 2021, we contingently liable for guarantees of indebtedness owned by 3rd party in the amount of $3M. (Relate to vendors, cx). Max future payment: not probable as we will be required to satisfy these guarantees.

[disclosure in footnotes + (most probable) : loss in Fin. Statement estimate

Events after balance sheet date:

* Contingent liabilities (nature : disclose in footnote / adjust in statements)
* Type I events: Affect estimates on book, not yet confirmed
  eg: estimate of uncollectible fund (not sure of resolution)
  ↳ confirm when bankruptcy filed.
  (After this : adjust)
* Type II : Not on books at all (Bal sheet date): no direct effect on audit
  eg: purchase / sale of division (non recognized events)
  Report in footnotes: not adjusted!

Note 21. Subsequent report

on Feb 1 2021, we agreed with XYZ 50M in cash. Subject to approvals. Expect next year!

Segment reports:

* Components within a company (Sports shoe, Leather shoe)
* Disclose info: Type, location, cx base (users can have info)

Note 25: Segment reporting

As of Dec 31 2021, our org has op segments in US, UK. US has most income from selling ____. Our UK section from selling ____

Onus on the preparer:

* Who is responsible for preparing notes & disclosure:
  follow!
  Company management & accounting staffs (AICPA)
* GAAP guides list all AICPA disclosure checklist.

* Hires independent CPA to verify! (Audit: Fairly stated, assert footnotes, disclosure)
* How make money, recorded, PPE, longterm, cash, investments, equity
* positive assurance: free of fraud & errors
* Reviews: CPA (no reason to believe info is uncorrect), conform with GAAP!
  Not a full blown audit
* Compilation: Compile statements: $\boxed{\text{omit footnote disclosures provided}}$: GAAP
  cash/tax accounting: compile to this version

$\boxed{\text{must declare in footnote: Not to influence users!}}$

Chapter 16: Studying the report to the share holders

* Heart of company's annual report to shareholders (owners, potential investor, media, credit
* Also: regulatory requirement.

why different: public (vs) private:

* Annual report differs: private: Just give mandate info (closely held)
* public: answers to people, external users [Audit: must].
* private: (No need for audit): only for business purpose they do (banding, ..

3 purposes:

* marketing, PR function: Brag accomplishments: Keep pumped up!
* State financial performance & goals: (Estimate? Reached?, plans) → Revenue, ↑ employee, manage effectiveness, ↑ base
* meeting regulatory requirements: must for (public comp)
  Certain criteria: private (also): SEC.

(let users know inner of a company): Boost confidence [mostly contracted: To firms prepare]

chair of board of directors:

* Head: oversee board (elected by shareholders): Approve CEO, CFO
* Day to day: managed by managements.

Key financial data:

* operation summary: bottom line net income (atleast 3 yrs (5-10)): profit, loss
* Earnings per share: Basic EPS: Net income / weighted avg of common shares (over year)

Diluted EPS: If issued stock options / longterm debt / preferred stock: investor can convert into common share.

$$\frac{100K}{33167} = 3.02$$

$$\frac{\text{Net inc}}{\text{Theory max no. of stocks}} = \frac{100K}{35200} = 2.84$$

1/1 to 7/1	6	30K	180K
7/1 to 9/1	2	37K	74K
9/1 to 12/31	4	36K	144K
(Time)			33167
months	No. of Shares		No. of Shares × month.

weighted average

$$= \frac{398000\ (12\ \text{months})}{12}$$

= weighted avg of no. of Shares

* Cash dividend: may/may not be same as EPS
* Balance sheet data: asset, liability.

Tout Company achievements:

* Chairman's letter to share holders (↑ growth, ↑ sales).
* Bond with CXS.

Future: Short/long term: address concern, estimate, review

	2019	2020	2021
Net op inc	100K	137K	125K
EPS (Basic)	3.02	4.13	3.77
Diluted	2.84	3.89	3.55
Cash div	1.43	1.75	1.59
Bal sheet data			
Total asset	37271	35630	40087
Long term debt	7857	4599	1385

Atleast 10yr plan: Growth prediction, economy transition, incoming

Key management & board members:

* management team (each division), committe members.

Form 10K:

* SEC requires with in 60days of fiscal year: File form 10k
    * class of security: public stocks/sell/buy: To people: must SEC
    * Assets/holders: > 10M, 2000+ investors/ 499+ creditors (investors)
    * publicly traded

4parts: Facing page + 4 add. parts: (form 10K)

* Facing page: Identify Company (name, add, number), title, class of securities with registered SEC.

Part I: Registrant details (what does, risk factor, year organized, form, bankruptcy proceeding, Business combination, change in method of business)

Part II: Reveal Performance: market info, financial highlights (NASDAQ), high & low + data

Management discussion & analysis: Trends (obesity trends: Restaurant)

Audited financial statements: policy, estimate, self explanatory notes, disclosures

↳ how regulates revenue, expense.

↳ enough evidence to prove error free (not resp for preparing statements)

Items under audit: Resp of management! (Follow GAAP, GAAS).

* Unqualified opinion: client can get (follow GAAP, GAAS) if audit conducted based on it.
* Qualified opinion: when no GAAP / no enough evidence to issue unqualified opinion
  ↳ users can know can't rely.
* Adverse opinion: Not good (only issued when departures from GAAP)
* Disclaimer of opinion: can't form an opinion (If not independent: Disclaimer given).

$\boxed{\text{eg: 263/281}}$

Part III: Identify & management & corporate governance:

* List directors, executive officers
* ethical behaviour, responsibility: Demand full & fair disclosure to make wise decision (pollution, resource usage).

$\boxed{\text{Code of Conduct: provide/mention where to find}}$

Part IV: exhibits, Financial Statement Schedules & signature:

* List document / number to send doc
* Last page: chairman's signature, chief financial officer, principal acc officer, attorney in fact (holding power)

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17. Accounting for emerging issues

* Pharma: Complicated (R&D, Tax Credits)
* Interruption (covid, calamities)
* Cloud Storage (backup, recovery): encryption, 2factor authorization.
* File sharing tools: permission, speed up approval, Have versions, e-sign, upload!

Virtual Currency: Taxed like property (using FIFO)

* Block chain: Recorded, unchangeable transaction (managed by users (chain))!

Pharma: (1.4 trillion by 2023): biotech

* Has specialized GAAP
* Section: R&D, marketing, supply chain (WHO, FDA, MHRA: patent, license).

Patents (GAAP): defensible up to 20yrs (after: approved to sold over counter).

2ways record cost
1. Bal sheet: asset
2. Inc sheet: Expense

* orphan drug (only 7yrs): AS vital.

* Book transactions: (exchange money for good/service)
permanent reduction in asset.

* FASB: expense rather than capitalize unless future use!
↳ "most public": wants to show profit! (Green: easy to borrow)

1. Drug in phase II (test no marketing or manufacture effort): expense
2. purchase lincense (after approval): capitalize
3. phase II: good results: Expense
4. Approval in US not spending to get in Spain: Expense

Before approval: produce (Based on risk) → Expense / → Capitalize.

GAAP rules: (To Bal sheet)

1. Cost have future benefit
2. XYZ obtains & controls benefit
3. Benefit already happened.

write off impairment (losses):

* Not recoverable: adjust books → Junk: 0 / → wholesale discounted price

* eg: market turndown (competitor/other case), change in business/legal climate,
premature disposal of asset!

Assets with indefinite life: Tested for impairment (yearly): Not amortized!

Net balance < future net cash flow → Book loss (Bal sheet ↓ asset)
P&L: Loss.

Machinery: Fixed asset (Depreciable):

* Any cost: up & running belongs to asset (capitalize)
* Any repair/error: expense.

$\boxed{\text{Ads: expense (when ad rolls/incurred)}}$ → Time b/w ad & reap benefit!

Credit R&D Cost:

* R & D, improve product/process/technique/Formula/Software: For sale, lease, License.

* encourage business: Tax Reform act 1986 (IRC 174, 41) & 41(d)(2)(B), 41(d)(1)(C)

IRC 174: R&D: Costs incurred (Lab/experiments)

IRC 41(d)(1)(b): Research (physical/biological sciences, Engg, CSE)

IRC 41(d)(2)(B): Result of research (sale/lease/license): To be used by business

IRC 41(d)(1)(C): process of exp (1/more ways: Uncertain at the beginning of the research)

effect: offset Costs (gap b/w cost & revenue): Dollar to dollar reduction in tax

expense reduction!

Constraints: Costs & expense:

* Not all costs qualify for the credit:

* quality: wage, supply, rental/lease of computer, contract research expense.

R&D: expensed (good practice: dedicated General ledger) Form 6765, 3800

Recognize losses:

* Covid: losses (Fire, Flooding, Huricane), Accidents

* mostly has coverage (insurance...): Revenue offset by expenses

properly expensing/accruing costs:

* expense: Asset destroyed (part of business interruption)

eg: Tree fallen on desk (computer): Loss on impairment

* Accrued: Complicated (Loans, AR from entities impacted by business impairment

Guide: ASC 310—10, ASC 450-20.

Contingencies: existing circumstance may loss/gain in future. (Footnotes)!

Chapter 18: Accounting for income taxes

* partnership: business doesn't : partners do!
* GAAP differs from IT accounting (revenue, expense differences exist): Temp/permanent

Financial (vs) Taxable income:

* Reporting standard: FASB (Prepare statements): vary b/w taxable income depreciation, modifications in payroll taxes). Users: Government agencies (Unlike GAAP)

* Income from Continuing op before Taxes: Reduce all losses, Expenses.
* Taxable Income: IRC is used rather than GAAP. (Form 1120: Report Tax return: C Corp)
1120S : S Corp
* 21% : Corporations (Research Credit, Foreign Tax credit: Canbedone) 1065 : partners.

Business may have: +ve (high) fin income Still (-)ve Taxable Income

→ Temp diff, Permanent diff, Loss carryforward.

Temporary difference: (Balance over time): Contingent liability, Depriciation → Book: SL, Tax: acceler.
(fixed, determinable: To record in Books)
Donation, estimates (allowance, warranty)
Net capital loss (Buy / sell)

permanent diff: Never report for tax! (Interest on municipal bonds: Tax: never taxed
GAAP: Taxed)
life insurance
meals entertainment (Tax: 50%)
penalties & fines
Special dividend received deduction: (not necessarily taxable)

Tax deferrals:
* Temporary diff b/w book & tax income: deferred tax assets & liabilities.
* when IT expense > payable: payable in future (liability)

Advantage of net operating losses:
* Deduct tax return! (pay bonus)
* Loss carryback: put entry (Receivable tax refund): asset in future!

Temp diff: Cash method, accelerated depreciation, Allowance for bad debt (Not tax deductible)

Deferred tax liability/asset to the balance sheet:
* Current / long time : depending on specific asset / liability
* AR (Allowance for bad debt): Current
* Doesn't specifically relate to any asset/liability: Classify based on when expected to reverse.
(12 months < : Short term).

Specific jurisdiction: Carry forward Tax of IRS: only IRS

Leases: chapter: 19

* 100% financing (↑ cash flow) [lessor: own, lessee: acquire lease]
* Computer, furniture: PP&E(lease) → no claim
* Advantage: no need for much cash (100% financing), frequent replacing, flexibility (no need to sell if not required), Reduce tax, Keep liability controlled (off the books): doesn't reflect on bal. sheet.
* Sometimes: Lessor may purchase after lease is confirmed to lease!

Lease:

* Financing / operating transaction. [ownership, immediate (vs) delayed expensing]

operating leases:

* Under ASC 2016-02 (FASB ASC 842): Lessees must record operating leases on balance sheet by booking the lease as a right of use asset & a matching lease liability on the balance sheet.
* Under this, if a lease is not operational, it is financing (viceversa).

cash ↓ (credit)
expense ↑ (debit)

Short term: No balance sheet entry (not under right of use):
Just expense

Booking under ASC 2016-02:

* 2010: SEC estimates lease obligation (amount of off balance sheet): Trillions $
* FASB, IASB under GAAP: ASU → >12 months lease: put on balance sheet.
  public, NGO, Non-profit, employee benefit programs

Finance leases:

* Characteristics of ownership: lessee assume responsibility, benefit, risk
* Cost goes on lessee's balance sheet as both asset (right of use) & liability.

Misguided impression: Agreement states operating lease, Treat it as such in Fin statements.
Not true!

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operational: Retain ownership until lease period. After that return
Lease payment: expenses (not in bal sheet): Shorter lease, Tax (fully deduct)

Financing: Become owner (risk & rewards), Record in bal sheet
Longer lease. Interest expense (liability), depreciation expense (asset)
(only interest expense, depreciation: Tax deductible).

Finance: (If any 1 of 5)

1. Transfer ownership (do depreciation for tax purposes)
2. can purchase the asset at the end of lease (age, condition: lower value)
3. Total lease period is atleast 75% of estimated life
4. present value of sum of all lease payments + Residual value > fair value.

* Asset no longer required for the lessor at the end

Sales type leases:

* Lease ≠ operating
* Lessor realizes both interest income + Profit/loss on transaction.

| Lessor : current/non current asset (direct/sales type financing) |

Reporting changes in methods & the correction of errors

* Incorrect entry (change in accounting principle, estimate, reporting entity)

Reporting changes:

* GAAP: Revenue, Expense, Asset purchase (choose ways: no one way in GAAP)
* Use fair, full, complete accounting for transactions reported on P&L, B.S, C.F.
* Collectively (follows, uses to apply principles): Accounting policies
* Property, equipment (GAAP): Straight line. Tax purpose (accelerated)

1. Preferable (management)
2. Required by GAAP
3. Improve estimate

Challenges:

1. Retrospective method
2. Report change in the earliest financial period.

2nd method used: when can't go through retrospective method.

Retrospective method:

* make change for current period + Going forward
* Show retained earnings balance: beginning, what it would be (after changed) All prior periods.

1. Figure out effect: adjust balances of any asset/liability → change depreciation, Acc. expense ↑↓
2. Take an offset entry for net assets to retained earning
3. Reflect change in accounting method for all prior periods: [Trend analysis also new method]

eg: LIFO from FIFO
Change policy for long term contracts
Professional pronouncement [By regulatory]

Impracticability exception:

* Adjust prior period (Impracticability exception arises)
* Exception: when can't determine effect as whole/specific in period.

So prospectively: Start of next year, future!

Conditions (GAAP) Impractical:

1. Assumption: understand management's goal (If turnover: Can't guess why?)
2. effort made: made effort (not going to work)
3. estimates required: (Barrier: not enough info to retrospectively figure)

Reclassify for accounting changes:

* Different from policy change
* occurs when change transaction. (Long term → short term) eg: move to new office.

* eg: Immaterial Change / required to be accurate (fin statement).

Immaterial: 5K for one is not immaterial for other (Their policy)

Reclassification:

* General ledger / fin statements, transaction involving them: include caption
* Explanatory note / disclosure in fin statements.

Switch to LIFO:

* closely match revenue to expense
* use opening inventory balance of 2021, proceed with LIFO
* Disclose in footnote: about change, how much.

Change estimates:

* Best guess: Sometimes fail / Better evidence.
* useful life (policy, past experience), Salvage value, AR collectability
  Contra accounts: (-)ve balance
* warranty costs

Handling changes currently & prospectively

* It affects both current & future periods (no change is done, prior period)
* change in estimate: affects only the current year. (10yrs life time, 8yrs (need to clear) → move to expense in year 8)

Changes in reporting entities:

* Reporting entities: parent company showing combined statement (50% + stake)
* If some change in subsidiary: Show in footnotes

1. make consolidated (not individual)
2. mix changes (mix of subsidiaries)
3. companies change!

* To show prior period changes: Retrospective!

error dealing: math, GAAP (recognition, fair value measurement, presentation (revenue-P&L), Disclosure), fact interpretation.

Counterbalance errors lie:

* smoothen 2 financial periods naturally: counterbalance (no action needed)
* eg: Depreciation! / Immaterial [Books not closed: Adjust beginning Retained earnings]
* Direct correction to retained earnings: prior period adjustments (SEC strict guidelines)

Restate fin statements:

* If material ⟶ 1) Adjust balance (asset, liability): at beginning
  2) Take second half of step 1 to retained earnings
  3) correct error on each fin statements.
  4) Provide notes (event, nature, effect ⟶ Net inc, income tax

Chapter 21: Ten Financial Accounting Shenanigans

1. Report revenue in wrong period:

* early: higher revenue [Accrual: only when earned/incurred]

2. Fictious income:

* Tax accountant: Reduce Taxable income (under GAAP)
* Financial accounting: ↑ income (not under GAAP)
  1) Channel Stuffing: cx buy more than need (year end): unspoken deal b/w cx & company. (refund: next year)
  2) Side agreement: Buy at \$100, Before due ⟶ \$50 (Inflate price artificially)

3. Increase income with misleading events:

* misclassify as income (Loan: liability but recorded as Gross receipt) Sale asset, equity, record interest/dividend.

No effect on net income but ratios change!

4. Shift expenses b/w periods:

* match revenue & expense (Boost income: shift expense: prior/future)
* pay vendor not record
* loan to shareholder: not matched revenue!
* Forget depreciation (asset not move to P&L) / ↓ cash, ↓ R.E instead of expense!

5. Misclassify cash: (unsustainable): pay vendors slowly (Shell game)

6. Fail to record liabilities: AP, unearned revenue, payroll accruals

★ record working capital as revenue (other way)

7. Reporting liabilities in the wrong period:

★ Year end: Hold on to vendor invoices (next period: entered)

Book inadequate warranty reserve (1% instead of 2%)

8. Not disclosing 3rd party transaction:

★ Loan to officers (never need to pay back) → liability ↑ affect current ratio.

$\boxed{\text{Disclosure: users are aware}}$

9. Capitalize normal operating expense:

★ Rebuild engine: Capital cost, oil: expense

★ misclassify: 1000s of car: impacts bottom line.

10. Delete transactions:

★ middle man manipulation: most softwares have audit trail

★ Reverse transactions (net zero)

★ Now: single sided entries: not possible.

★ 2 books (time, fear)!

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opportunities: Chapter 22

1. CPA (statement, assurance service (attestation))

2. Consultant

3. Corporate accountant (Controller, departmental accountant, internal auditor)

4. Forensic accountant (legal dispute / litigation) → CPA

→ certified fraud examiner

→ " in financial forensics

5. Govt accountant

6. Information technology auditor

7. Income tax accountant

8. International accountant

9. Non accounting accountant (Create personalized accounting software)

10. Non profit accountant.