REVIEW FOR ACCOUNTING

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GRADING POLICY

Class participation	10%
Problem sets	40%
Final exam	50%

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CONTENT

Summary for Chap. I

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1. Why accounting information is useful for information users?

1) It's relevant to decision making, accounting links decision makers with economic activities.

2) Companies need accounting to "communicate" with each other;

2. A general idea of the advantages of modern accounting?

1) Accounts for revenue, expenses, and the company's resources and liabilities. ----> **Shows more details. (resources and liabilities)**

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BASIC FUNCTIONS OF AN ACCOUNTING SYSTEM

In developing information about the activities of a business, every accounting system performs the following basic functions:

1. *Interpret and record* the effects of business transactions.
2. *Classify* the effects of similar transactions in a manner that permits determination of the various *totals* and *subtotals* useful to management and used in accounting reports.
3. *Summarize and communicate* the information contained in the system to decision makers.

——*Financial & Managerial Accounting: Basis for Business Decision*

Summary for Chap.2

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1. Three main financial statement
   1) Balance Sheet (Statement of Financial Position)
   2) Income Statement
   3) Statement of Cash Flows
2. Assets = Liabilities + Equity
3. Basic structrure of Balance Sheet & Income Statement

VAGABOND TRAVEL AGENCY STATEMENT OF FINANCIAL POSITION DECEMBER 31, 2015			
Assets		**Liabilities & Owners' Equity**	
Cash	$ 22,500	Liabilities:	
Notes Receivable	10,000	Notes Payable	$ 41,000
Accounts Receivable	60,500	Accounts Payable	36,000
Supplies	2,000	Salaries Payable	3,000
Office Equipment	15,000	Total Liabilities	$ 80,000
Building	90,000	Owners' Equity:	
Land	100,000	Capital Stock	150,000
		Retained Earnings	70,000
Total	$ 300,000	Total	$ 300,000

Balance Sheet

VAGABOND HOTEL INCOME STATEMENT FOR THE PERIOD Jan 1- Dec 31, 2015		
Sales revenue	$ 12,500	
Cost of goods sold	5,000	
Gross margin		7,500
Operating expenses		
Wage expense	1,200	
Rent expense	200	
Total operating expenses		$ 1,400
Net Income		
		$ 6,100

Income Statement

4. Basic asset, liability, and equity accounts

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Assets:

Current Assets	Non-current Assets
1.Cash 2.Accounts Receivable 3.Inventory (Supplies)	PP&E (Property, Plants & Equipment)

Liabilities:

Current Liabilities	Non-current Liabilities
1. Accounts payable 2. Other payable	1.Notes payable (long-term debt)

Owners'(Shareowners'/ Stockowners') Equitiy

1) Capital Stock

2) Retained earnings ----> Increasing yearly

Retained earnings for period (t-1)

\+ Net income for period t

-Dividends for period t

= Retained earnings for period t

Retained earnings are the portion of a company's profits that are not distributed as dividends to shareholders but instead are kept within the company for future use. Essentially, they are the cumulative earnings that a company has kept over time rather than paying out to shareholders.

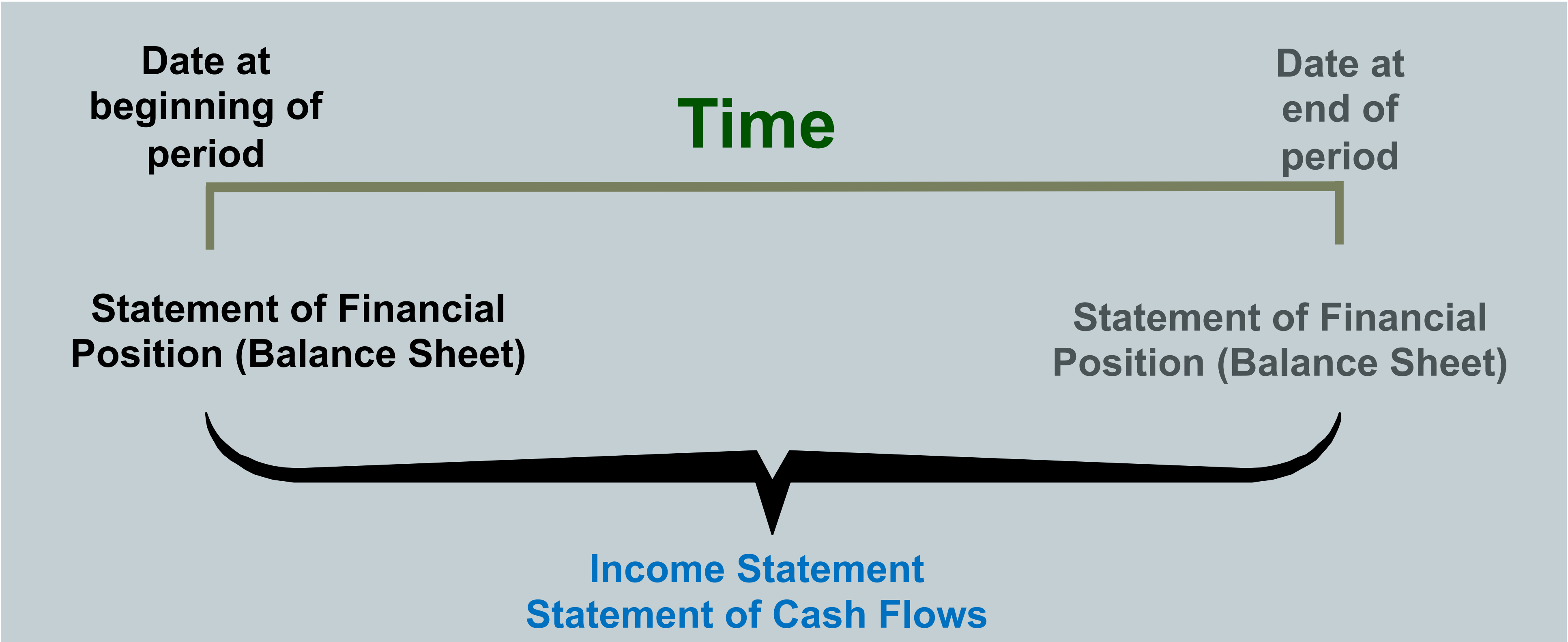
Retained earnings can be used by a company for a variety of purposes, such as reinvesting in the business, paying off debt, or making acquisitions. By retaining earnings, a company can build up its financial strength and flexibility, which can help it weather downturns or take advantage of growth opportunities.

Retained earnings are reported on a company's balance sheet as a component of equity, alongside other items such as common stock and additional paid-in capital. They are also an important indicator of a company's financial health and can be used by investors to assess the company's long-term prospects.

5. Basic Revenues ang Expenses

- -Expenses
  - -Cost of goods sold
  - -Wage expense, rent expense
- -Revenues

6. Relationship:



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OVERNIGHT AUTO SERVICE
STATEMENT OF CASH FLOWS
FOR THE PERIOD JANUARY 20-31, 2015

Cash flows from operating activities:		
Cash received from revenue transactions	$ 2,200	
Cash paid for expenses	(1,400)	
Net cash provided by operating activities		$ 800
Cash flows from investing activities:		
Purchase of land	$ (52,000)	
Purchase of building	(6,000)	
Purchase of tools	(6,800)	
Sale of tools	600	
Net cash used by investing activities		(64,200)
Cash flows from financing activities:		
Sale of Capital Stock		80,000
Increase in cash for the period		$ 16,600
Cash balance, January 20, 2015		-
Cash balance, January 31, 2015		$ 16,600

OVERNIGHT AUTO SERVICE
INCOME STATEMENT
FOR THE PERIOD JANUARY 20 - 31, 2015

Sales Revenues		$ 2,200
Operating Expenses:		
Wages	$ 1,200	
Utilities	200	$ 1,400
Net Income		$ 800

OVERNIGHT AUTO SERVICE
BALANCE SHEET
JANUARY 31, 2015

Assets		Liabilities	
Cash	$ 16,600	Notes payable	$ 30,000
Accounts receivable	1,200	Accounts payable	7,000
Tools & equipment	12,000	**Owners' Equity**	
Building	36,000	Capital stock	80,000
Land	52,000	Retained earnings	800
Total assets	$ 117,800	Total liabilities & equity	$ 117,800

Summary for Chap.3

1.How to make journal entries:

1)Debit and Credit balance sheet accounts, dividends, and income statement accounts.

Debit: Increases of Assets ; Decreases of Liabilities & Equities

Credit: Decreases of Assets ; Increases of Liabilities & Equities

2)Debits=Credits

Note: Expenses are the negative part of Retained Earnings(Equity), so we debit it

2.How to post journal entries to ledgers (T accounts):

For every account, we make a ledger in the shape of "T". Debit on the left and Credit on the right.

3.How to make a trial balance:

From all ledgers we calculate the exact amount of every account, then put the together in a trial balance.

Note that $\sum Debit = \sum Credit$.

4.Accrual basis of accounting:

1) Revenue recognition principle:

Revenue **should be recognized at the time goods are sold and services are rendered.**

2) Matching principle:

Expenses **should be recorded in the period in which they are used to generate revenue.**

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5. Adjusting entries

1) Why do we need an adjusting entry?

a. Accrual basis of accounting need to hold true for each accounting period

b. We record revenues and expenses when there was an observable transaction, but some revenues and expenses are accrued and unrecorded.

2) four types of adjusting entries:

A. Transactions That Affect Multiple Periods

a. Generated Revenue But Did Not Collect Cash
b. Collected Cash But Has Not Generated Revenue

Revenue Recognition

c. Incurred Expense But Has Not Paid
d. Paid for Expenses in Advance

Expense Recognition

a. Generated Revenue But Did Not Collect Cash

Accounts Receivable (Dr) & Revenue (Cr)

Note that there may exist a Time-crossing Circumstance, we need to compute the mean and calculate the specific number

b. Collected Cash But Has Not Generated Revenue

Cash(Dr) & Unearned Revenue[deferred revenue, advance from customers](Cr)

c. Incurred Expense But Has Not Paid

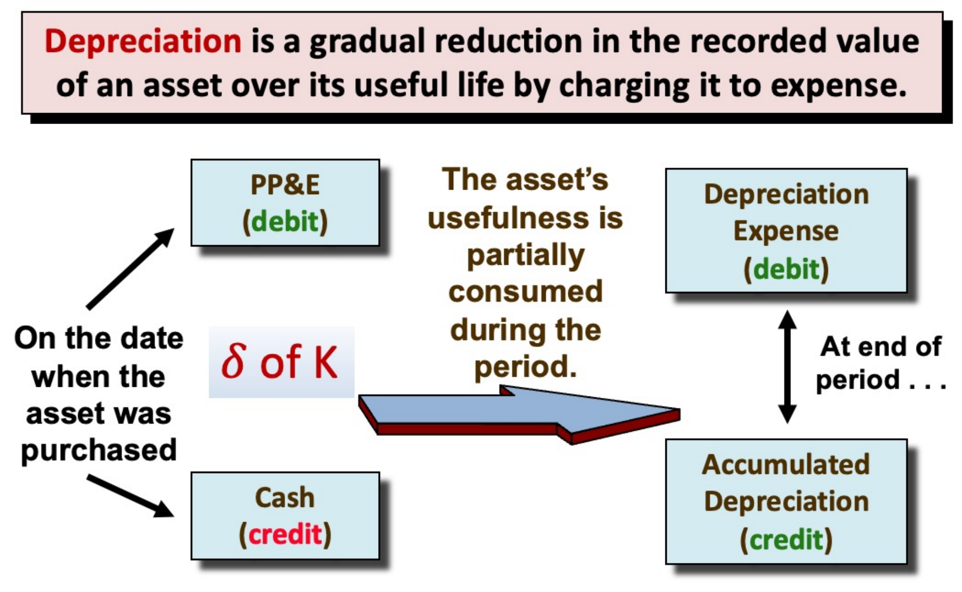
xxx Expense(Dr) & xxx Payable(Cr)

d. Paid for Expenses in Advance

Unexpired[prepaid] xxx(Dr) & Cash(Cr)

Only an estimate
A contra-asset

Note that there may exist Depreciation Expense & Accumulated Expense.



Straight-line method: the object depreciates evenly.

For convenience, we assume that the residual revenue in the end is 0.

$$\text{Depreciation expense (per period)} = \frac{\text{Cost of the asset} - \text{Residual Value (\$0)}}{\text{Estimated useful life}}$$

A. Transactions That Affect Multiple Periods

……(Shown in before Notes)

B. Four types of adjusting entries

❶Accruing uncollected revenue

❷Converting liabilities to revenue

❸Accruing unpaid expenses

❹Converting assets to expenses

Finally, accrue income taxes expense.

6. Preparing adjusted trial balance

   1) Post adjusting entries to ledgers

   2) Retained earnings is still zero at this step

7. Preparing financial statements

   1) Income statement

   2) Statement of retained earnings

   3) Balance sheet

8. Closing the Temporary Accounts

   1) Clear the balance of dividends and income statement accounts, so that in the next period, these accounts start from zero balance.

   2) Update retained earnings by adding net income and subtracting dividends.

Four steps to make closing entry:

1) Close Revenue accounts to Income Summary.
2) Close Expense accounts to Income Summary.
3) Close Income Summary account to Retained Earnings.
4) Close Dividends to Retained Earnings.

Summary for Chap.4

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1.Basic profitility & liquidity ratios:

- **Profitability**
  - How is the company's ability to generate profits?
    - Return on assets (ROA) = Net income / Total assets
    - Return on equity (ROE) = Net income / Total equity
    - Net profit margin = Net income / Sales

The higher, the better

- **Liquidity**
  - Can the company pay off its short-term liabilities?
    - Current ratio = Current assets / Current liabilities
    - Cash ratio = Cash / Current liabilities

2.Cash

1)Cash management and internal control

a. Cash is defined as any deposit banks will accept
[paper money; checks; securities; credit card sales……]
Note that Cash equivalents are very safe and stable investments, usually with a maturity of 90 days or less, such as treasury bills and high-grade commercial papers. We regard them as cash.

b. "Cash Over and Short" appears in the income statement as other expense if it has a debit balance, and as other revenue if it has a credit balance.

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2) Reconciling the Bank Statement

a. Compare the deposits

b. Adjust the bank statement

   (i) add deposits in transit

   (ii) deduct outstanding checks

   (iii) add/deduct bank errors

c. Adjust the company's own records

   (i) add interest revenue

   (ii) deduct service charges and NSF (not sufficient funds) checks

   (iii) add/deduct errors

d. Compare the balances

   [reconcile until the two balances are equal]

A briref illustration:

Balance per Bank

+ Deposits in Transit

- Outstanding Checks

± Bank Adjustments

= Adjusted Balance

Balance per Depositor

+ Deposits by Bank (credit memos)

- Service Charge
- NSF Checks

± Book Adjustments

= Adjusted Balance

2.Accounts Receivable

1)Accounts receivable is defined as the money owed to a company for goods or services that have been delivered but not yet paid for.[Defined as a current asset]

2)Allowance for Doubtful Accounts

a. A contra-asset account

b.

Accounts receivable

Less: Allowance for doubtful accounts

Net realizable value of accounts receivable

The **net realizable value** is the amount of accounts receivable that the company expects to collect.

c. Two ways to estimate:

(i) Balance Sheet Approach--------------------- Calculate a Sum of Expectations

(ii) Income Statement Approach---------------- Use a specific Scale to estimate

d. The Practice:

Dr Uncollectible Accounts Expense

Cr Allowance for Doubtful Accounts

e. Write-off

(i) When an account is determined to be uncollectible, it no longer qualifies as an asset and should be written off (i.e., removed from the balance sheet).

(ii) Practice:

Dr Allowance for Doubtful Accounts

Cr Accounts Receivable

Write off, or remove from the balance sheet

Notice that the write-off did not change the net realizable value and did not affect any income statement accounts.

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f. Recovery of an Account Receivable Previously Written Off

practice:

Dr Accounts Receivable
Cr Allowance for Doubtful Accounts

Recover the accounts written off before

Dr Cash
Cr Accounts Receivable

Record changes in balance sheet

3)Management of Accounts Receivable

Two ways to get cash more quickly:

a. Factoring Accounts Receivable

- Companies can sell their accounts receivable to financial institutions (e.g. banks) for a lower price.
- This allows the company to obtain cash immediately instead of waiting to collect accounts receivable.

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b. Credit Card sales

- Some widely used credit cards (e.g., Visa and MasterCard) are issued by banks. Companies can deposit the credit card payment directly in its bank account.
- If the company can immediately receive cash from the credit card sale, then it can be recorded as a *cash sale*.

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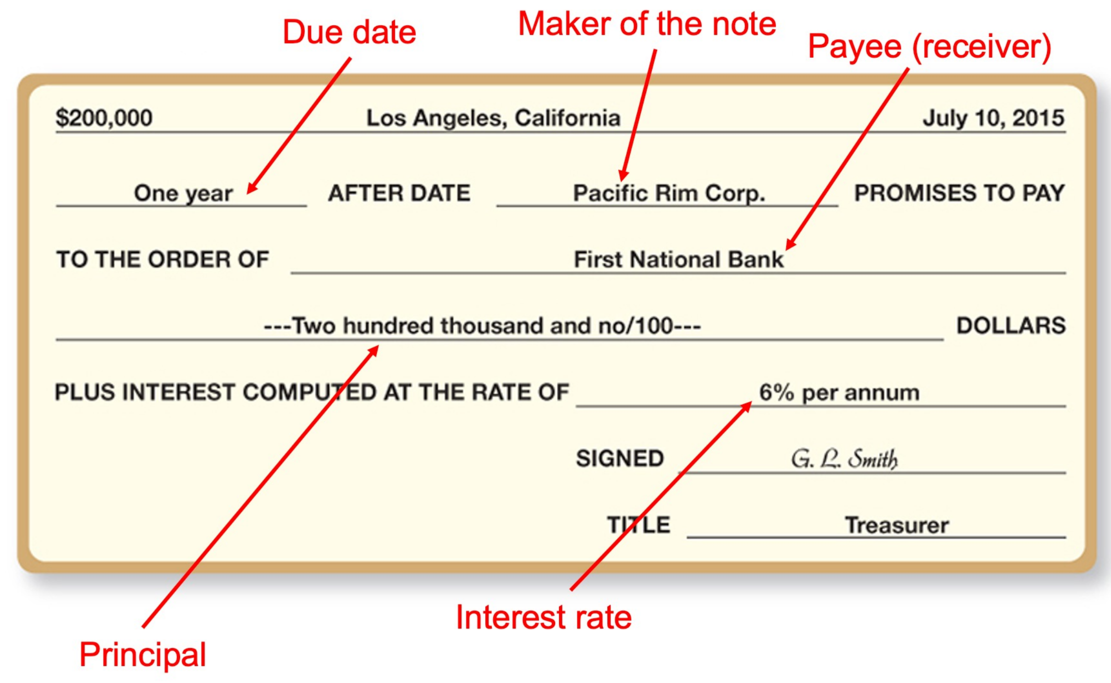
3.Notes Receivable

1) A note receivable is a written promise to receive a specific amount of cash from another party at a future date. The promises are documented with a promissory note, which outlines the terms and conditions of the repayment.

2) Usually interest-bearing. Used for larger transactions and is more formal and legally binding.



Interest = Principal × Interest Rate × Time

(Note that the interest receivable and interest revenue should be recorded separately from note receivable)

4. Accounts Receivable Turnover Rate

$$\frac{\textbf{Net Sales}}{\textbf{Average Accounts Receivable}}$$

being higher means more efficient in transforming accounts receivable into cash.

$$\text{Days Sales Outstanding} = \frac{\textbf{365}}{\textbf{Accounts Receivable Turnover Ratio}}$$

Lower days sales outstanding means greater efficiency.