Chapter 5

Short term investments- liquid, second to cash, holds for less than a year, recorded after cash on the balance sheet
3 categories securities: trading, available for sale, hold to maturity
Trading securities- if market price of investment increases, it's a gain (act like revenue). If market price of investment decreases (act like expense), it's a loss. Recorded at market value on balance sheet
*Unrealized means not sold
Realized gain: sale price > investment
Realized loss: sale price< investment
Journals: Purchase, debit investment credit cash.
Received dividend, debit cash, credit dividend revenue
*Dividends/Unrealized on income statement under other revenue and gains
FOB Shipping point- ownership changes hands and revenue is recognized when goods leave seller, buyer owns while in transit, buyer pays shipping
FOB destination- ownership changes hands and revenue is recognized when goods arrive to buyer, seller owns in transport, seller pays shipping
Sales discounts- offered to customers when paid early, (2/10 n/30), contra asset account
Journal for discount: debit cash, debit discount, credit accounts receivable
Sales returns and allowances-returned merchandise
Journal: debit sales returns and allowances, credit accounts recievable
Gross revenue, less discounts, less sales returns/allowances =Net revenue
Receivables- on account (selling goods) and notes (lending money)
Cash collections=Beg Accts Rec+Sales-End Accts rec
Subsidiary ledger- separate account for every customer, combined make up the general ledger
Journals: debit accounts receivables credit sales revenue. Debit notes receivable credit cash.
Internal control over cash- separate cash handling from accounting
*Selling on credit increases cash flow but there will be uncollectible accounts
Allowance for uncollectible accounts- contra asset
Net realizable value= Accts Rec- AUC
Journal: allowance: debit uncollectible account expense credit allowance for uncollectible accounts rec. write off: debt AUC credit accts
*entry to record uncollectible accts affected by decrease net income and decrease assets
Methods to estimate uncollectible
1) percent of sales- income statement approach, multiple estimated % uncollectible by revenue
2) Aging- balance sheet approach, aging schedule, individual accounts from customers are analyzed on how long they have been unpaid
*Estimated AUC-Unadjusted AUC=Adjusting entry
Direct write off- not GAAP, no estimation, only right off after they don't pay
Notes receivable- loaning money
Creditor=lender, debtor=borrower, interest=principle*interest rate*month/12, maturity value= principle+interest, principle is initial amount borrowed
Journals: debit note receivable credit cash. Debit interest receivable credit interest revenue. Debit cash credit interest receivable interest revenue and note receivable.
*If adjusting entries to accrue interest on note receivable is omitted then assets, net income, and equity are understated
*Total interest revenues- recognized interest rev=remaining interest revenue

Chapter 6

Inventory- the cost of inventory on hand is an asset on the balance sheet, # of units on hand*cost per unit, number of units verified by records, do not include consignment of other companies, do include our consignment
COGS- the cost of inventory that's been sold and is expense on the income statement, # of units sold*cost per unit
Sales revenue=sales price, COGS=cost of inventory sold, inventory=cost, gross profit= sales revenue-COGS
Periodic system- updated at the end of the period, won't keep running record of items, used for low cost items (ex) bolts at a hardware store
Perpetual-updated continuously with purchases, keeps running record of all inventory on hand, counts inventory annually
Journals- Purchase*: debit inventory credit accounts payable/cash. Sold it: debit accounts recievable/cash credit sales revenue. Recorded COGS: Debit COGS credit inventory
Balance sheet- current assets: inventory
Income statement- sales, less COGS=gross profit, less returns and allowances, discounts= Net sales
*Cost of inventory= purchase price, add freight in, add taxes or fees, less returns, allowances, discounts=net purchases
Four methods
1) Specific unit-unique items
2) Average cost- weight average, cost of goods available/number of units available *BI+Purchases
COGS=number sold*average cost
EI= number left*average cost
3) FIFO- first in first out, COGS are oldest items, EI are newest items, if not given take total price/total items and use that for prices
4) LIFO- last in first out. COGS are newest items, EI are oldest items
*BI+Purchases-EI=COGS first, then above
Impact on financial statements
When rising: FIFO lowest COGS highest EI; LIFO highest COGS lowest EI
When decreasing: FIFO highest COGS lowest EI; LIFO lowest COGS highest EI
Tax advantage of LIFO: results in lowest income, lowers income tax, increase cash available
*buying large amounts of inventory near end of year will show less income
*show more income by delaying purchases
Other comparisons: LIFO has most realistic measurement of COGS and net income, FIFO reports most up to date EI inventory costs
*Financial statements should use a consistent method, disclose relevant and representationally faithful info that an outsider can make informed decisions
Lower cost of market: inventory is reported on balance sheet at whichever is lower, historical cost or replacement cost *if replacement cost falls under historical cost must write down the value of its goods at market value, if market above no
Journal: debit COGS credit inventory

Income statement- sales revenue, less COGS= gross profit, less operating expenses= income before tax*income tax =Net income

Effects of inventory errors

*error effects 2 accounting periods

EI Overstated: Period 1, COGS under, Gross profit/net income over. Period 2, COGS over, gross profit/net income under

EI Understated: Period 1, COGS over gross profit/net income under. Period 2, COGS under, gross profit/net income over

*Does not affect sales, BI, purchases, goods available.

**BI and goods available affect in 2nd period, mirror EI of first period

Chapter 7

Plant asset- long term asset, property plant or equipment, expense is depreciable

Costs of Plant Assets

Land: purchase prices, add commission/survey fees/back taxes/grading and clearing/removing buildings, not depreciable

Constructed buildings: architecture fees/material/labor/interest on funds borrowed

Purchased building: purchase price, add broker's commission/taxes/costs to repair and renovate

Equipment: purchase price, add transportation/insurance in transit/sales tax/installation/testing/platforms

*Once working, repairs and maintenance are expenses

Land improvement: parking lots, drive ways, signs, fences, different from land and depreciable

Lump sum- buying land, building, and equipment all at once.

1) Add all market values together

2) Divide out each expense into a percent

3) Multiply percents by purchase price, that is assets the cost

Journal: Debit land, building, equipment credit note payable

Capital expenditures- increases assets capacity or useful life, cost is added to the asset

Immediate expense- costs that don't extend capacity or life, just repairs or maintenance that restore it to working order, recorded as an expense on the income statement

Accounting errors with expensing

*expense a cost that should be capitalized- overstates expenses and understates net income, revenues stay the same

*Capitalize an expense, understates expenses and overstates net income, revenue stays the same

*Book value=Cost – Accumulated Depreciation

Depreciation- allocation of cost over plant asset's life. Caused by wear and tear and obsolescence (useful life may be shorter than physical life), decreases an asset and equity, when asset is used Accumulated depreciation increases and book value decreases, final book value=residual value, accum deprec is contra asset

*Not valuation process or a fund to replace assets

Amounts needed to determine: Cost, estimated useful life, estimated residual or salvage value

Depreciations methods- allocate different amounts of depreciation each period but all result in the same total amount of depreciation

*Depreciable cost=asset's cost- estimated residual cost

Straight line- equal amounts of depreciation per year (cost- residual value)/useful life in years

Units of production

Depreciable cost/useful life in units*use of asset

Double Declining Balance Method- accelerated, writes more off at beginning than at end

DDB rate= 2/years of use*original cost(no subtraction of residual value)

*for final year, take original cost less accumulated depreciation and multiply by DDB rate

*Fails to report cost=overstate net income/assets

Comparing methods

Highest net income:straight line, lowest: DDB

Straight line best matches revenue it produces

Units of production is best for assets that wear out w/ use

Accelerated method best for assets that generate more revenue early on in useful life and less in later years

Straight line most popular for financial statements

Accelerated most popular for income taxes

Depreciation for tax- allowed to use different methods, accelerated preferred because it provides fastest tax deductions thus decreasing immediate tax payments

Depreciation for partial years- used for straight line and DDB only. 1) compute full year depreciation 2) multiply that by the fraction of months/12

Changing useful life 1) compute depreciation 2) depreciable book value= cost-accum deprec-residual value 3) take second and divide by new estimated useful life

Fully depreciable assets- an asset that has reached the end of its estimated useful life, zero residual value, book value zero but could possibly still be used

Disposal of asset- 1) update depreciation because it measures final book value and records the expense up to date of sale 2) remove asset and accum deprec from books

Journal: debit accum deprec credit asset name

Disposal before fully used could result in a loss

Journal: debit accum deprec debit loss on disposal credit asset

Selling plant asset-Journal: debit depreciation expense credit accumulated depreciation (to update). Sale: debit accum depre credit asset (original cost) credit gain on sale (cash received from sale+book value), could be loss so debit loss

*Gain= cash received > book value*Loss= cash received < book value

Nonmonetary exchange- replace old with new, gain is when fair value > book value, loss when fair value< book value

Natural resources- depleted not depreciated

Journals: debit oil reserve credit cash (finding/purchasing). Debit oil inventory credit oil reserve (depletion). Debit cost of oil sold credit oil inventory (sold oil). Remember that cost per barrel (total cost/total barrels=cost per barrel*how many removed) also remember the millions/1000 for billions

Intangible assets- no physical forms, amortization like straight line and credited directly to asset account

Patents- federal government grants that give the hold the exclusive right for 20 years to produce and sell invention, product or process Journal: Debit patent credit cash. Debit amortization expense credit patent.

Copyright- exclusive right to reproduce and sell a creation and extends 70 years past creators life

Trademark- brand names, useful life set by contract or indefinite

Franchises- priviledges to sell product or service in accordance to guidelines. Indefinite life

Goodwill- defined as excess of cost of purchasing another company over the sum of their assets, not amortized