

Exam I Study Guide

Disclaimer: The following guide is intended to provide a brief overview of some of the material that we have covered up until October 17, 2013 in ACCTG 215. This is not intended to provide a comprehensive overview of all material that could be examined in Exam I. I encourage you to read the textbook on your own and also attempt the "not required" practice problems on Connect. Doing practice problems is very important and helpful in accounting!

Chapter 1: Financial Statements and Business Decisions

- What the four financial statements are, what they show, and how are they related to each other - balance sheet, income statement, statement of stockholders' equity, cash flow statement
 - Balance sheet: reports economic resources a company owns, and the source of financing for the resources.
 - Income statement: reports the company's ability of selling products for more than the cost of the production.
 - Statement of Stockholders' Equity: reports the transactions between shareholders. (additional contributions or payments of investors, and amount of income the company reinvested for the future growth)
 - Cash flow statement: reports a company's ability to generate cash, and how it was used.

- Different elements (accounts) of financial statements and what they are - e.g., assets, liabilities, equity, revenues, expenses
 - Asset: Economic sources which owned by a company.
 - Liability: The amount of financing for the company's resources provide by creditors or lenders.
 - Equity: The amount of financing economic resources provided by owners of the business and reinvested earnings.
 - Revenues: Amount of money that expected to receive from customers by providing goods or services that have been delivered to the customers.
 - Expenses: The dollar amount of resources that a company used to earn revenue.

- Which accounts go on which financial statement (look at the examples in the textbook to get used to different account names and where they are reported (e.g., see page 131). Connect also has a lot of examples in the not required exercise problems) - see exhibit 2.3 on page 48 for common account names
- Various terminology - what they stand for and what they are/do
 - o GAAP: General Accepted Accounting Principles - measurement and disclosure rules used to develop the information in financial statements
 - o IFRS: International Financial Reports Standards - issued by IASB
 - o SEC: Security and Exchange Commission - The US government agency that determines the financial statements that public company should provide to stockholders and the measurement rules that they must use in producing those statements.
 - o FASB: Financial Accounting Standards Board - a private sector given the primary responsibility to work out the detailed rules that become GAAP.
 - o IASB: International Accounting Standards Board

- o PCAOB: Public Company Accounting Oversight board - a private sector given the primary responsibility to issue detailed auditing standards for independent auditors (CAPs)
- Preparing financial statements given the required information and/or trial balance
- Difference between current assets and non-current assets (same for liabilities)
Assets: probable future economic benefits owned by an entity as a result of past transactions.
Current asset: assets that will be used or turned into cash within one year.
Ex: Cash, Short-term investment, Account receivable, Inventory, Supplies, Prepaid Expense...
Non-current asset: include long-term asset (equipment & property) and intangible asset
Ex: PP&E, Investment (in other companies), trademarks, patents...
Liabilities: probable future sacrifices of economic benefits arising from present obligation of an entity as a result of past transactions.
Current liability: obligations that will be settled by providing cash or other current assets within one year.
Non-current liability:
- Key equations:
 - o $A = L + SE$
 - o $\text{Net Income} = \text{Revenues} - \text{Expenses}$
 - o $\text{Stockholders' Equity} = \text{Contributed capital} + \text{Retained Earnings}$
 - o $\text{Ending RE} = \text{Beginning RE} + \text{Net Income} - \text{Dividends}$

Chapter 2: Investing and Financing Decisions

- Exhibit 2.4 on page 55 gives an overview of how the accounting cycle works and the different steps involved from analyzing transactions to preparing financial statements
Transaction:
 1. External Transaction: exchanges of assets or services for assets, services, or promises to pay between other business
 2. Internal Transaction: measurable internal event such as adjustment for the use of assets in operations.
P.S Making a contract or order some supplies are NOT Transactions!
- Recording external transactions
 - o Determine the account, amount, and direction (how does this affect the accounting equation)
 - o Determine whether to debit or credit affected accounts (debits on the left, credits on the right) - see the figures in textbook and notes for how each account is increased/decreased with a debit/credit (hopefully this is easy by now!!!)
 - o Record journal entries (remember debits=credits)
Journal Entry: recording transactions using debits and credits
 - o Post transactions to the ledger (T-accounts)
T-account: a tool for summarizing transaction effects for each account (every journal entry links to two or more T-accounts)
 - o Prepare a trial balance
Trial balance: aggregates the ending balances of all T-accounts (the final step before making balance sheet)
- Key equations:

- o Debits = Credits
- o Current ratio = Current Assets/Current Liabilities
(measures the ability of a company to pay its short-term obligations with short-term assets)
→ higher current ratio: more cushion a company has to pay its current liabilities if future economic conditions take a downturn

Chapter 3: Operating Decisions

- Operating income = operating revenue - operating expenses (e.g., page 103)
 - o Sale of goods or services (operating revenue)
Revenue: increase in assets or settlements of liabilities from ongoing operations
 - o Cost of goods sold (COGS), salaries, wages, rent, insurance (operating expenses)
Expenses: outflows of using the up assets or increases in liabilities from ongoing operations incurred to generate revenues (not all cash expenditures are expenses, but expenses are necessary to generate revenues)
 - o Depreciation expense (allocates the cost of assets over their useful lives)
When a company uses buildings and equipment to generate revenues, a part of cost of these assets is reported as an expense called Depreciation Expense
- Income tax - if firms make a profit they have to pay tax (last item on income statement before net income)
Provision for income tax
- Cash vs. Accrual accounting
 - o GAAP requires accrual accounting - revenues are recognized when they are earned and expenses when they are incurred
 - o Cash basis accounting: records revenues when cash is received and expenses when cash is paid
 - o Accrual accounting: records revenue when earned and expenses when incurred, regardless of timing of cash receipts or payments
- Revenue realization principle (page 106) - criteria for recognizing revenue
 - Goods or services are delivered
 - There is persuasive evidence of an arrangement for customer payment - customer has provided cash or a promise to pay cash
 - The price is fixed or determinable - there are no uncertainties as to the amount to be collected
 - Collection is reasonably assured - for sale on credit, company has to make sure that customer is able to pay
- Expense matching principle - costs incurred to generate revenues be recognized in the same period
 - Requires that costs incurred to generate revenue be recognized in the same period - a matching of costs with benefits
- Gains and losses from sales of assets (difference between selling price and cost of asset on the books)
- Format of income statement → operating revenues, operating expenses, other revenues, other expenses,