Review of Accounting Concepts

Assets

Assets = items owned by the firm, valued at historic cost.
  Short-term Assets = items typically held for less than a year.
  Long-term Assets = items typically held for over a year.

Short-term Assets

  Cash = currency and marketable securities.
  Accounts Receivable (Rec) = short-term credit extended to customers.
  Inventories (Inv) = stocks of goods waiting to be used, completed or sold.
    Raw Materials
    Work in Process = goods in process of being produced.
    Finished Goods = goods ready to be sold.

Long-term Assets

  Property, Plant & Equipment (PP&E)
  Intangible Assets (Patents, Goodwill, etc.)

Liabilities and Equity

Liabilities = funds borrowed by the firm.
Equity = value of assets net of liabilities.

Liabilities

  Accounts Payable (Pay) = short-term credit extended by suppliers.
  Debt = face value of loans.

Equity

  Stock = funds provided by shareholders.
  Retained earnings = earnings not paid out as dividends.
Balance Sheet

\[ \text{Assets} = \text{Liabilities} + \text{Equity} \]

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities + Equity</th>
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</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Accounts Payable (Pay)</td>
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<tr>
<td>Accounts Receivable (Rec)</td>
<td>Debt</td>
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<tr>
<td>Inventories (Inv)</td>
<td>Stock</td>
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<tr>
<td>Long-Term Assets</td>
<td>Retained Earnings</td>
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<tr>
<td>– Accumulated Depreciation (AccDep)</td>
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Income Statement

Revenues (\(Rev\)) = revenues from operations during the accounting period.

Cost of Goods Sold (\(COGS\)) = costs incurred in producing or purchasing goods sold during the accounting period.

Sales, General and Administrative Expenses (\(SG&A\)) = other costs incurred during the accounting period.

Depreciation Expense (\(Dep\)) = scheduled writeoffs of historic costs for long-term assets acquired in previous periods.

Interest Expense (\(Int\)) = interest paid to creditors during the accounting period.

Asset Disposal

Disposal Value of Asset (\(Salv\)) = revenue from or cost of asset disposal.

Historic Cost of Asset (\(HC\)) = amount paid for asset at time of purchase.

Gain on Asset Disposal (\(Gain\)) = effect of disposal on pretax earnings:

\[ Gain = \text{Disp} + \text{AccDep} - \text{HC}. \]

Pretax Net Income (\(PNI\)):

\[ PNI = Rev - COGS - SG&A - Dep - Int + Gain. \]

Tax Liability (\(Tax\)) = tax liability incurred during the accounting period.

Net Income (\(NI\)) = Pretax Net Income minus Tax.

\[ NI = PNI - Tax. \]

\(NI\) minus dividend payout is added to Retained Earnings at the end of the accounting period.
Debits and credits

Transactions involve debits and credits of equal value.

- Debits add to Assets and subtract from Liabilities.
- Credits subtract from Assets and add to Liabilities.
- Revenues are credits (since they add to Retained Earnings)
- Expenses are debits (since they subtract from Retained Earnings)

Examples of transactions

Asset purchase: Debit the asset account, credit Cash.
Asset sale: Debit Cash, credit Long-Term Assets, debit Accumulated Depreciation.

Raw material purchase: Debit Raw Materials, credit Cash or Pay.
Raw material usage: Debit Work in Process, credit Raw Materials.
Wage payment: Debit Work in Process or SG&A, credit Cash or Pay.
Completion of goods: Debit Finished Goods, credit Work in Process.
Purchase of goods for resale: Debit Finished Goods, credit Cash or Pay.
Sale of finished goods: Debit Cash or Rec, credit Rev. Also debit COGS, credit Finished Goods.

Loan: Debit Cash, credit Debt.
Loan repayment: Debit Debt and Int, credit Cash.
Dividend payout: Debit Retained Earnings, credit Cash.