From the homework problem:
The issue of tangible vs intangible and the order they are listed in does not really come up on the Income Statement. But in a way it comes into play. Typically in the revenue stream in a single step income statement your going to list operating revenue before listing non-operating revenues. Sales are an operating revenue, that's what a business does in its operations, it generates sales. In the expenses that gets a lot grayer. There are three possibilities, all of which are widely used.

1) list operational expenses, then non-operational expenses, then income taxes.
2) Larger amounts first and smaller amounts last
3) Alphabetical listing

NET: after accumulated depreciation. Depreciation is a negative number which represents the write off of the equipment over time. Net represents the number of the gross cost after deduction of that accumulated write off. That's why they call it net.

In a typical unclassified balance sheet those two would be combined, they would not break out Current Maturities of Long Term Debt would be combined as Long Term Debt and then in the notes to the financial statements the next five years of principal maturities would be listed in the notes to the financial statement. That's where you would get that detail. Current Maturities of Long Term Debt, which is the principal of long term debt that is going to be repaid within the next 12 month period from the date of the balance sheet. This is also known as Current Portion of Long Term Debt.

Total Liabilities and Stockholders Equity is a line that you must come up with. Without it there is no balance. **The balance sheet must demonstrate that the assets balance with the liabilities and stockholders equity**.

Statement of Retained Earnings

What exactly does it do? This is not actually one of the three required statements but in a lot of cases a company will include their statement of retained earnings of their reconciliation of retained earnings or their recapitulation of retained earnings. This is done by taking the opening balance of retained earnings on 12/31 of the prior year and adding earnings of period and subtracting dividends declared in the tracked period. This gives us our ending balance of retained earnings on 12/31 of the current year.

Schedule of Retained Earnings	
Retained Earnings, December 31, Year 8	2,044,975
Add net income for year 9	474378
Subtract Dividends Declared and Paid during Year 9	-133499
Retained Earnings, December 31, Year 9	**2,385,854**

Dividends declared and Paid will not show up on the balance sheet but will show up on the cash flow statement. But not always given the cash flow statement so some detective work comes

into play. In the above example we deduced the value of dividends declared because we knew the other three items. This may happen a lot. The key is to know the things that change. We can deduce certain changes in any account by knowing one of the two things that change. Of course you must have all the other elements of the equation (sometimes this will not be the case).

Example:
Cash Account. If you know the opening balance and you know what the deposits were for the period then by deduction you can determine what the withdrawals were for the period because you now what the ending balance was.

Dividends

The board of directors declares a dividend.
There are 3 key dates in the dividend process:

1) Date of Declaration
2) Date of Record
3) Date of Payment

Accounting entry is made at the date of declaration at which point a liability is established and a debit to retained earnings is made. It will show up as a liability until paid. At the point of payment it will come off the liability account and become a deduction to cash (?)

EVERY EVENT, TRANSACTION, ENTRY, HAS TWO SIDES TO IT.

At this point we understand what goes on an income statement and balance sheet.

See here a series of transactions for this company. We will be going through this and some other data and actually DO THE BOOKS.

ASSETS = LIABILITIES + SHAREHOLDERS EQUITY

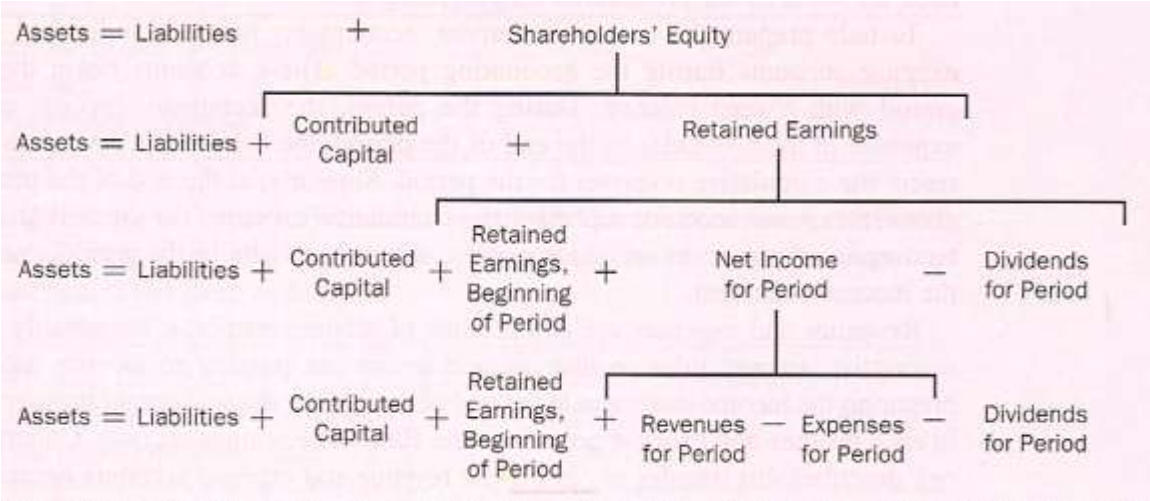
[DR] [CR] [CR]

SHAREHOLDERS EQUITY = COMMON STOCK + RETAINED EARNINGS

Retained Earnings = Opening Balance + Net Income (curr period)

Net Income (curr period) = Sales – Expenses

Retained Earnings End Balance = Net Income Current Period – Dividends Current Period



Now we want to add an understanding of the system of debits and credits that accountants use to record transactions. Every transaction has to be analyzed in terms of what accounts are effected by that transaction and then a system of debits and credits are used to record that transaction.

What are **Debits** and **Credits**? They are complete opposites of each other. Like positives and negatives.

Every account has an inherent type of credit or debit balance. One or the other. It normally carries a specific type of balance, either a credit balance or a debit balance.

We must memorize the nature of the balance in each and every account. Must be second nature.

Almost all **Assets** typically carry debit balances denoted **DR**.
Almost all **Liabilities** typically carry a Credit Balances denoted **CR**.
Stockholders Equity typically would have a Credit Balance.

In this way the debits equal the credits, the system must balance.

We know there are several components to Stockholders Equity and each has it's own typical balance.
Common Stock: CR

Opening Balance in Retained Earnings: CR (if profitable)
Sales: CR
Expenses: DR
Dividends Declared: DR
Dividends Payable: CR (because it's a liability)

From this we see if we have more sales than we have expenses than net income would be a credit number. And it would add to retained earnings (cause to go up) which would cause stockholders equity to go up. Which would probably be balanced by the cash we made with that income on the other side which would have been a debit and those two things would be in balance.

System: every account on the Asset side have debit balances (with the exception of one or two) and all of the liability and stockholders equity accounts, with the exception of expenses and dividends declared, have credit balances.

IN EVERY TRANSACTION AT LEAST TWO ACCOUNTS ARE AFFECTED.
(COULD BE MORE BUT AT LEAST TWO)

From this tenet we get the term **DOUBLE ENTRY BOOKKEEPING**, always at least two entries.

Example:
Say we want to show an increase in the Cash account. It normally carries a debit balance and we want to show it is now higher we would have to DEBIT that account. If, on the other hand, cash is going down in the transaction because we are spending money and we want to show an account which normally has a DEBIT balance is now lower we must CREDIT the account.

Same thing with Liabilities, if we want to show liabilities going up and liabilities normally have a credit balance then we have to CREDIT the account. To show liabilities going down we would DEBIT the account.

Example:
Every transaction affects two accounts. Say we sell something for cash, what two accounts are affected? CASH and SALES ! Cash goes up, cash normally has a debit balance and we want to show that it has more of a debit balance so we DEBIT the cash account. Likewise, the SALES account normally has a CREDIT balance and we want to show that sales are higher now so we will CREDIT the sales account.

Example:
Say we barrow money from a bank. Now have more cash but also have a liability. We must debit cash to show its higher and credit the liability account to show we owe more money.

Example:
Say we sell common stock for cash. Credit the common stock account to show there is value in that account and debit the cash account to show we sold a portion of the company.

DEBITS MUST ALWAYS EQUAL THE CREDITS. THIS IS THE SYSTEM BY WHICH THIS IS IMPLEMENTED.

There is no such thing as a one sided entry!

Now lets look at the exceptions.

Accumulated Depreciation: this is an exception. When you buy a piece of equipment which has a life greater than one year you call it a capital asset. Shows up on the balance sheet as property, plant, & equipment. The way that we write off that cost to the income statement is through a process known as depreciation. We depreciate the asset. Say we buy a $10,000 piece of equipment and it has a five year life. Every year for the next 5 years we would write off (on a straight line basis) $2000 from the balance sheet and we would charge it to the expenses we call Depreciation Expense. On the balance sheet we would accumulate all of those write offs.

Example:
Equipment worth $10,000 the first year is a DR (equipment has a 5 year life).
Depreciation Expense would be a DR.
Buy equipment for $10,000 at time zero and then at time 1 write off $2000 which becomes a CR to the depreciation Account. At the same time this is a DR on the equipment account. In year 2 write off another $2000 which is credited to the Depreciation Account for a total Accumulated Depreciation of $4000 in year 2. year 3 Accumulates to $6000 and keeps going till all written off.
We are not reducing the asset, we're keeping the gross cost, but we are putting a contra-asset account on the balance sheet which then reduces the net book value of that asset down so at the end of 3 years the net book value will be only $4000. At the end of the 5 year life the net book value will be zero because we will have totally written off the cost of that asset. This is one of the exceptions. The CONTRA-ASSET Accumulated Depreciation bears normally a **CREDIT** balance.

This is not a worth issue, appraisers do worth. Also, LAND never depreciates whereas buildings do. Accounting for cost, not a valuation. Accounting for what it cost you, not what it is worth. This is an important accounting principle, the principle of objectivity. We base our reporting on objective verifiable evidence and not on the basis of subjectivity. Accounts would say something like "show me the check you wrote for that building and I'll account for it."

Chapter 3, pg 127, pb 3.3

PROBLEM 3.3 FOR SELF-STUDY

Journalizing transactions during a period. Harris Equipment Corporation began operations on January 2, Year 2, with the issuance of 10,000 shares of $10-par value common stock for $15 cash per share. The firm engages in the following transactions during Year 2:

1. January 2, Year 2: Acquires a building costing $80,000 and equipment costing $40,000. It pays cash in the amount of $60,000 and assumes a 10-percent mortgage for the balance of the purchase price. Interest is payable on January 2 of each year, beginning one year after the purchase.
2. January 2, Year 2: Obtains a two-year fire insurance policy on the building and equipment. It pays the insurance premium of $1,200 for the two-year period in advance (debit an asset account).
3. During Year 2: Acquires merchandise on account totaling $320,000. It makes payments to these suppliers during Year 2 totaling $270,000.
4. During Year 2: Makes sales of merchandise totaling $510,000, of which $80,000 is for cash and $430,000 is on account. Collections from credit customers during Year 2 total $360,000.
5. During Year 2: Pays employees' salaries totaling $80,000.
6. During Year 2: Pays utility bills totaling $1,300.
7. November 1, Year 2: Receives a $600 cash advance from a customer toward the purchase price of merchandise to be delivered during January, Year 3. NOT DELIVERED
8. November 1, Year 2: Receives a $1,000, 9-percent, 90-day note from a customer to settle an open account receivable. CUSTOMER OWES 1000, CANT PAY, CONVERT INTO A 90 DAY NOTE @ 9% INT
9. December 1, Year 2: Rents out a portion of its building for a three-month period. The firm received the rent for the period, $900, in advance (credit a revenue account for the full amount received).

Give the journal entries to record these nine transactions during Year 2. (The next self-study problem analyzes adjusting entries at the end of Year 2.) Omit explanations for the journal entries.

CONTINUES ON PAGE 135

PROBLEM 3.4 FOR SELF-STUDY

Journalizing adjusting entries at the end of the period. Refer to the data for Harris Equipment Corporation in Problem 3.3 for Self-Study. Give the adjusting entries on December 31, Year 2, to reflect the following items. You may omit explanations to the journal entries.

10. The building acquired on January 2, Year 2 (see transaction **(1)** in Problem 3.3 for Self-Study), has a 20-year estimated life and zero salvage value. The equipment has a seven-year estimated life and $5,000 salvage value. The firm uses the straight-line depreciation method.
11. The firm recognizes insurance expense on the fire insurance policy obtained on January 2, Year 2 (see transaction **(2)** in Problem 3.3 for Self-Study).
12. After the firm takes a physical inventory at the end of the year, it finds the cost of merchandise sold during Year 2 to be $180,000 (see transaction **(3)** in Problem 3.3 for Self-Study).
13. The firm recognizes interest expense on the mortgage liability for Year 2 (see transaction **(1)** in Problem 3.3 for Self-Study).
14. Salaries earned by employees during the last three days of December total $800. The firm will pay them on January 4, Year 3.
15. The firm recognizes interest revenue on the note receivable (see transaction **(8)** in Problem 3.3 for Self-Study).
16. The firm makes an adjusting entry to record the proper amount of rent revenue for Year 2 (see transaction **(9)** in Problem 3.3 for Self-Study).
17. The firm declares dividends of $25,000. It will pay the dividend on January 15, Year 3.
18. The income tax rate is 40 percent of net income before income taxes.

Journal Entries

	DR	CR
00		
Cash	$ 150,000	
Common Stock		$ 100,000
APIC		$ 50,000
01		
Building	$ 80,000	
Equipment	$ 40,000	
Cash		$ 60,000
Mortgage		$ 60,000
02		
Prepaid Expense - Ins	$ 1,200	
Cash		$ 1,200
03A		
Inventory	$ 320,000	
Acct Payable		$ 320,000
03B		
Acct Payable	$ 270,000	
Cash		$ 270,000
04A		
Cash	$ 80,000	
Acct Rec	$ 430,000	
Sales		$ 510,000
04B		
Cash	$ 360,000	
Acct Rec		$ 360,000
05		
Salary Exp	$ 80,000	
Cash		$ 80,000
06		
Utility Exp	$ 1,300	
Cash		$ 1,300
07		
Cash	$ 600	
Advance from Customer		$ 600
08		
Notes Rec	$ 1,000	
Acct Rec		$ 1,000

	DR	CR
09		
Cash	$ 900	
Rental Income		$ 900
10		
Depreciation Exp	$ 9,000	
Accumulated Depreciation		$ 9,000
11		
Insurance Exp	$ 600	
Prepaid Exp - Insurance		$ 600
12		
Cost of Goods Sold	$ 180,000	
Inventory		$ 180,000
13		
Interest Exp	$ 6,000	
Interest Payable		$ 6,000
14		
Salary Exp	$ 800	
Salary Payable		$ 800
15		
Interest Receivable	$ 15	
Interest Revenue		$ 15
16		
Rental Income	$ 600	
Advances from Tenents		$ 600
17		
Dividends Declared	$ 25,000	
Dividends Payable		$ 25,000

	Mortgage	Note Rec
Principle	$ 60,000	$ 1,000
Interest rate / yr	10%	9%
Interest expense / yr	$ 6,000	$ 90
# months outstanding / 12 months x	12 / 12	$ 2 / $ 12
Interest Accurable	$ 6,000	$ 15

	Building	Equipment
Cost	$ 80,000	$ 40,000
Salavge Value	$ -	$ (5,000)
	$ 80,000	$ 35,000
Life in years	20	7
Depreciation exp / yr	$ 4,000	$ 5,000

T-Accounts

Cash	
DR	CR
$ 150,000	$ 60,000
$ 80,000	$ 1,200
$ 360,000	$ 270,000
$ 600	$ 80,000
$ 900	$ 1,300
$ 591,500	$ 412,500
$ 179,000	

Acct Rec	
DR	CR
$ 450,000	$ 360,000
	$ 1,000
$ 450,000	$ 361,000
$ 89,000	

Inventory	
DR	CR
$ 320,000	$ 180,000
$ 320,000	$ 180,000
$ 140,000	

Interest Rec	
DR	CR
$ 15	
$ 15	$ -
$ 15	

Building, Equip., Prop.	
DR	CR
$ 120,000	
$ 120,000	$ -
$ 120,000	

Accmulated Dep	
DR	CR
	$ 9,000
$ -	$ 9,000
	$ 9,000

Notes Rec	
DR	CR
$ 1,000	
$ 1,000	$ -
$ 1,000	

Acct Payable	
DR	CR
$ 270,000	$ 320,000
$ 270,000	$ 320,000
	$ 50,000

Interest Payable	
DR	CR
	$ 6,000
$ -	$ 6,000
	$ 6,000

Salaries Payable	
DR	CR
	$ 800
$ -	$ 800
	$ 800

Advances fr Tenants	
DR	CR
	$ 600
$ -	$ 600
	$ 600

Prepaid Exp	
DR	CR
$ 1,200	$ 600
$ 1,200	$ 600
$ 600	

Dividends Payable	
DR	CR
	$ 25,000
$ -	$ 25,000
	$ 25,000

Mortgage Payable	
DR	CR
	$ 60,000
$ -	$ 60,000
	$ 60,000

Common Stock	
DR	CR
	$ 100,000
$ -	$ 100,000
	$ 100,000

APIC	
DR	CR
	$ 50,000
$ -	$ 50,000
	$ 50,000

Dividends Declared	
DR	CR
$ 25,000	
$ 25,000	$ -
$ 25,000	

Sales	
DR	CR
	$ 510,000
$ -	$ 510,000
	$ 510,000

Cost of Goods Sold	
DR	CR
$ 180,000	
$ 180,000	$ -
$ 180,000	

Salary Exp	
DR	CR
$ 80,000	
$ 80,000	$ -
$ 80,000	

Insurance Exp	
DR	CR
$ 6,000	
$ 6,000	$ -
$ 6,000	

Utilities Exp	
DR	CR
$ 1,300	
$ 1,300	$ -
$ 1,300	

Depreciation Exp	
DR	CR
$ 9,000	
$ 9,000	$ -
$ 9,000	

Interest Revenue	
DR	CR
	$ 15
$ -	$ 15
	$ 15

Rent Income	
DR	CR
$ 600	$ 900
$ 600	$ 900
	$ 300

Interest Exp	
DR	CR
$ 6,000	
$ 6,000	$ -
$ 6,000	

Trial Balance: sum of all the accounts by credit or debit.

	DR	CR
Cash	$ 179,000	
Acct Rec	$ 69,000	
Inventory	$ 140,000	
Interest Rec	$ 15	
Building, Equip., Prop.	$ 120,000	
Accmulated Dep		$ 9,000
Notes Rec	$ 1,000	
Acct Payable		$ 50,000
Interest Payable		$ 6,000
Salaries Payable		$ 800
Advances fr Cust & Tenants		$ 600
Prepaid Exp	$ 600	
Dividends Payable		$ 25,000
Mortgage Payable		$ 60,000
Common Stock		$ 100,000
APIC		$ 50,000
Dividends Declared	$ 25,000	
Sales		$ 510,000
Cost of Goods Sold	$ 180,000	
Salary Exp	$ 80,000	
Insurance Exp	$ 600	
Utilities Exp	$ 1,300	
Depreciation Exp	$ 9,000	
Interest Revenue		$ 15
Rent Income		$ 300
Interest Exp	$ 6,000	
	$ 811,515	$ 811,715

[BALANCED]

Financial Statements

Income Statement		
Revenue		
Sales	$ 510,000	
Interest Income	$ 15	
Rent Income	$ 300	
Total Revenue	$ 510,315	
Expenses	(not including Prepaid, future bebefit, asset)	
COGS	$ 180,000	
Salary	$ 80,800	
Insurance	$ 600	
Utility	$ 1,300	
Depreciation	$ 9,000	
Interest Income	$ 6,000	
Total Expenses	$ 277,700	
Net Income	**$ 232,615**	

Statement of Retained Earnings	
Opening Balance	$ -
Add Net Income	$ 232,615
Subtract Dividends Declared	$ (25,000)
End Balance of Retained Earnings	$ 207,615

Balance Sheet	
Assets	
Cash	179000
Acct Rec	69000
Inventory	140000
Notes Rec	1000
Interest Rec	15
Prepaid Exp	600
Building & Equip.	120000
Accumulated Dep	-9000
Total Assets	500615
Liability & Shareholders Equity	
Liabilities	
Acct Payable	50000
Interest Payable	6000
Salary Payable	800
Adv fr Cust/Ten	1200
Mortgage Payment	60000
Dividends Payable	25000
Total Liabilities	143000
Stockholders Equity	
Common Stock	100000
APIC	50000
Retained Earnings	$ 207,615
Total Sharehold. Equity	357615
Total L & SE	**500615**

[notes from exercise, listed by transaction number]

00: Total stock sale is 10,000 * $15 = $150,000. Break this up by PAR value.
The Cash account is debited by the $150,000. DR (increased)
Common Stock gets 10,000 * 10 = $100,000 CR (holds PAR value)
Additional Paid In Capital (APIC) gets 10,000 * (sale price – PAR value = 5) = $50,000 CR
(notice debits = credits)

01: Building, Property, and Plant $80,000 (debit, inc)
Equipment: $40,000 (debit, inc)
Cash: $60,000 (credit, dec)
Mortgage Payable: $60,000 @ 10% (credit, inc)

02: Prepaid Expense - Insurance: $1200 (debit) this is an asset
Cash: $1200 (credit)
When you pay for something in advance you haven't yet used the thing you've paid for. In which case it is considered a Prepaid ASSET or EXPENSE. In above it is an asset.

03A: Acquires Merchance on Account
Inventory: $320,000 (DR)
Acct Payable: $320,000 (CR)

03B: Payments to Suppliers
Cash: $270,000 (CR)
Acct Payable: $270,000 (DB)

04A: Sales of Merchance
Sales: $510,000 (CR)
Cash: $80,000 (DR, inc)
Acct Rec (AR): $430,000 (DR, inc)

04B: Collections
Cash: $360,000 (DB)
Acct Rec: $360,000 (CR) no longer owed this money

05: Salary Payable
Cash: $80,000 (CR)
Salary Exp: $80,000 (DR)

Take your que from the wording. If they say PAY that means they used CASH. If they say they INCURED that means they have not yet paid. ACCRUED also means they haven't yet paid.

Name your account exactly what they are, Rent, Salary, Utilities, Equipment, etc.

But keep in mind the "last name". For instance could have Salary Payable (hasn't been paid yet), Salary Expense (goes to the income statement because its an expense). The surname is very important! Tells what it is exactly.

06: Utilities
Utility Exp: $1300 (DR)
Cash: $1300 (CR)

Consider a cash advance toward the purchase of merchandise to be delivered. We have received cash in, must debit cash account. And must credit something but not sales because we have not yet delivered, have not earned the sale so cannot call it a sale. Money in advance of a sale is called Advance From Customer which is a liability.

In order for a sale to be a sale it has to meet two criteria. Must be EARNED and REALIZABLE. Students always get this one wrong. Must remember this!
Earned means they preformed the job, there performance is substantially complete. **Realizable** means they have the money or there is a reasonable chance they will be paid (customer has good credit record).

Note: customer could not pay so arranged credit with seller at a certain percent. Signed a note. Now if customer still does not pay they are taken to court. Much easier to collect on a note than on a overdue account, the note has the customers signature acknowledging the debt. The account would be Notes Rec. (DR). Later we will adjust this entry for interest received.

Normally rent payment made in advance would be logged under liability but this problem specifies that it be credited to a revenue account. Reason is that they will adjust this entry later. So we are going to credit rental income now even though we have not earned it yet. Debit cash for $900 and credit Rental Income for $900. Later in period will adjust.

Adjusting Entries: Depreciation

	Building	Equipment
Cost	$ 80,000	$ 40,000
Salavge Value	$ -	$ (5,000)
	$ 80,000	$ 35,000
Life in years	20	7
Depreciation exp / yr	$ 4,000	$ 5,000

Now make a journal entry, DR to Depreciation Expense and a credit to Accumulated Depreciation. The total is $9,000. Accumulation Depreciation is a Contra-Asset account and normally has a credit balance. We're showing that going up so we credit that and debit the expense. Basically writing off a portion of the cost of the asset and expensing it.

Insurance: paid for several years but only part used. Say half. One of the two years.
Debit Insurance Exp for 1/2 , $600

Credit Prepaid Exp – Insurance $600 (to remove it from the balance sheet).

Whenever there is a sale there is always a cost of the sale. At the time of sale you should also record the cost of the sale. These are two separate entries. Sale: what you sold and what you got for it. Cost of Sale: account for the cost of the items when we bought them as well as the cost of having them in inventory.

Come out of Inventory and goes into Cost of Goods Sold. Increase expenses under cost of goods sold (DR) and credit Inventory.

Mortgage Interest:
Interest is always quoted on a per-anum basis (annual) unless otherwise specified.

		Mortgage
Principle		$ 60,000
Interest rate / yr		10%
Interest expense / yr		$ 6,000
# months outstanding	x	12
12 months		12
Interest Accurable		$ 6,000

The interest exp per year is $6000 but the number of months outstanding (when they took out the mortgage) is 12 (took out in Jan) and the interest accruable is $6000. Would have been different if they had taken it out at another point in the year.

Pay for something out of cash.
Recognize something as a liability.

Accrual Basis Accounting: we recognize and record entries in the books of account when we have incurred an expense or liability or we have earned revenue or other income. This is GAAP. Making an Accrual Basis entry almost always affects balance sheet accounts (either assets or liabilities) as well as income or expense accounts.

We will have to produce Journal Entries, T-Accounts, Trial Balances, and Financial Statements. All must be demonstrated.

Tricks to correct an out of balance balance statement:

1) If it is divisible by 9 it maybe a transposition error.
2) If you mistakenly add a negative number, your out of balance difference will be twice the amount mistakenly subtracted.

Homework

Pg 93 pb 25
Disregard fact that it is in pasioes.
8 entries to make, do all 8. in addition to those on

Pg 157 pb 23
Do the first 14 entries (not the income tax one).

Total of 22 entries to make, just run them together like in class.