Accounting

I. 9.1: Plant Assets (Property, Plant, and Equipment; Plant and Equipment; Fixed Assets)
   a. physical substance
   b. used in operations of a business
   c. not intended for sale to customers
   d. everything except land declines in service potential over useful lives

II. Determining the Cost of Plant Assets
   a. Cost consists of all expenditures necessary to acquire the asset and make it ready for its intended use
   b. **Land** → "Land" Account title
      i. Cost of land includes
         1. cash purchase price
         2. closing costs such as title and attorney's fees
         3. real estate brokers' commissions
         4. accrued property taxes and other liens assumed by purchaser
      ii. All of these costs must be debited (increase) to Land Account
         1. Including cleaning, draining, filling, grading → include in cost of land
         2. Removal of old buildings, etc
   c. Land Improvements
      i. Structural additions made to land

ii. Ex: driveways, parking lots, fences, etc → do NOT include in cost of "Land"

iii. Have LIMITED useful lives

iv. Maintenance and replacement are the responsibility of the company

v. Expense (depreciate) the cost of land improvements over their useful lives

d. Buildings

i. Facilities used in operations

ii. Ex: stores, offices, factories, etc

iii. DR Buildings account (all expenditures related to **purchasing** construction of building)

1. Purchase price
2. Closing costs (attorney's fees; title insurance, etc)
3. Real estate broker's commission
4. Costs to make ready (remodeling, repairing, interest costs, wiring/plumbing)
5. Interest costs incurred to finance project

iv. Building is **constructed**

1. Costs include: contract price + payments for architects' fees; building permits; excavation costs

v. "Buildings" account

        1. interest costs are included in cost of building when **SIGNIFICANT** period of time is required to get the building ready for use
        2. inclusion of interest costs = limited to the construction period
        3. DR (increase) Interest Expense when construction is completed → company records interest payments on funds borrowed

e. **Equipment**
    i. Assets used in operations
    ii. Ex: counters, furniture, machinery, trucks, etc
    iii. Cost of equipment
        1. Cash purchase price
        2. Sales taxes
        3. Freight charges
        4. Insurance during transit (paid by purchaser)
        5. Assembling/installing/testing these units
        6. DO NOT INCLUDE insurance and licenses bc they do not benefit future periods
            a. Motor vehicle licenses
            b. Accident insurance

f. Depreciation: The process of allocating to expense the cost of a plant asset over its useful (service) life in a rational and systematic manner; process of COST ALLOCATION

i. Occurs due to
    1. Wear and tear
    2. Obsolescence
ii. Deprecation is a process of cost allocation. NOT a process of asset valuation
    1. Not applied to Land (usefulness actually grows)
    2. Dependent upon usefulness → becomes less and less useful = prone to depreciation
iii. **Book value (cost - accumulated depreciation)** = can be different from its fair value
    1. Can have 0 book value but STILL have significant fair value
iv. 3 classes of plant assets → depreciable asset (wear and tear)
    1. land improvements
    2. buildings
    3. equipment
v. obsolescence: process of becoming out of date before the asset physically wears out
vi. recognizing depreciation on an asset does not result in an accumulation of cash for replacement of the asset
vii. Accumulated Depreciation: total amount of the asset's cost that company has charged to expense; NOT a cash fund
viii. Going concern assumption: the company will continue in operation for the foreseeable future

1. Does not use this assumption → plant assets stated at fair value; depreciation of these assets not needed

g. Factors in computing Depreciation
   i. Cost
   ii. Useful life: an estimate of the expected productive life/service life of the asset for its owner
   iii. Salvage value: an estimate of the asset's value at end of its useful life

h. Depreciation Methods → ALL acceptable under GAAP
   i. Types
      1. Straight line: expense the same amount of depreciation for each year of the asset's useful life; measured by the passage of time
         a. Most popular method
         b. Cost - salvage value = depreciable cost
         c. Depreciable cost / useful life (in years) = annual depreciation expense
         d. can calculate annual rate as well (100% / # years) to determine percentage
         e. if you purchase an asset DURING the year → prorate the annual depreciation
            i. (cost) x (rate) x (#/12 of a year)
            ii. ex: rate is 100%/5 years = 20%
            iii. own truck for 9 months of first year

iv. ans: 12,000 x 20% x (9/12) = 1800

2. Units of activity: useful life expressed in terms of the total units of production of use expected from the asset rather than as a time period
    a. Good for factory machinery, delivery equipment, airplanes (when the productivity of an asset varies significantly from one period to another)
    b. Not good for buildings, furniture, etc
    c. Easy to apply for assets purchased mid year
    d. Formula:
        i. Depreciable cost / total units of activity = depreciable cost per unit
        ii. (Depreciable cost per unit)(units of activity during the year) = annual depreciation expense
    e. my way:
        i. (units of activity)(depreciation cost/unit) = annual depreciation expense
        ii. book value – annual depreciation expense = new book value
3. Declining balance
    a. Produces a decreasing annual depreciation expense over the asset's useful life

b. Based on declining book value (cost – accumulated depreciation)
c. Depreciation rate remains constant from year to year, but the book value to which the rate is applied declines each year
d. Does NOT use depreciable cost in computing annual depreciation expense
e. **Ignores salvage value** in determining the amount to which the declining balance rate is applied
    i. Does not limit the total depreciation that can be taken
    ii. Depreciation stops when the asset's book value = expected salvage value
f. Double declining balance method: Declining balance rate is double the straight line rate
    i. In previous example: 2 x 20% = 40%
    ii. Book value at beginning of year x declining balance rate = annual depreciation expense
g. Accelerated depreciation method: Produces higher depreciation expense in the early years than in later years
    i. To determine percentage of how much equipment has depreciated:

ii. Accumulated Depreciation value at end of # year / Accumulated Depreciation value at the last year of equipment's life

iii. Compatible with **expense recognition principle**

h. **Provides most appropriate depreciation when assets lose usefulness rapidly due to obsolescence**

ii. Depreciable cost: cost of the asset less its salvage value; total amount subject to depreciation

iii. Company decides which method is best based on assets

iv. Consistency

v. Affects balance sheet and income statement

i. Comparison of Methods

i. Total depreciation is the same for the 5 year period under all three methods (straight line, units of activity, declining balance)

ii. Depreciation and Income Taxes

1. IRS : Internal Revenue Service

a. allows taxpayers to deduct depreciation expense when they compute taxable income

b. does not require taxpayers to use the same depreciation method on the tax return that is used in preparing financial statements

2. **most companies use Straight line in financial statements to maximize net income**
3. MACRS
    a. Modified accelerated cost recovery system
    b. **use special accelerated depreciation method on tax returns to minimize income tax**

j. Revising Periodic Depreciation
    i. Management should PERIODICALLY review annual depreciation expense
    ii. Change in estimate
        1. change in current and future years
        2. does NOT change depreciation in prior periods
    iii. Calculation Format → make NO entry for change in estimate; describe in financial statements significant changes in estimates
        1. Book Value, date
        2. Less: Salvage Value
        3. Depreciable Cost
        4. Remaining useful life (in years)
        5. Revised annual depreciation (depreciable cost / remaining useful life)

III. Expenditures During Useful Life
    a. Ordinary repairs: expenditures to maintain the operating efficiency and productive life of the unit

        i. Frequent
        ii. Ex: motor tune ups, oil changes, paintings, etc
        iii. DR Maintenance and Repairs Expense (as these revenue expenditures are incurred)
    b. Additions and improvements: costs incurred to increase the operating efficiency, productive capacity, or useful life of a plant asset
        i. Infrequent
        ii. Increase investment in productive facilities
        iii. DR these capital expenditures to the plant asset that is affected
    c. Materiality: refers to the impact of an item's size on a company's financial operations
    d. Materiality concept: if an item would not make a difference in decision-making, the company does not have to follow GAAP in recording that item

IV. Plant Asset Disposals
    a. Must determine the book value of the plant asset at the disposal date to determine the gain or loss
        i. To eliminate the book value
            1. DR Accumulated Depreciation for the total depreciation associated with that asset to the date of disposal
            2. CR the asset account for the cost of the asset
    b. Retirement of plant assets
        i. When equipment is fully depreciated, book value = 0
        ii. Entry format

- Accumulated Depreciation – Equipment
    - Equipment
        - (To record retirement of fully depreciated equipment)

iii. fully depreciated plant asset is still useful to company?

1. **Asset and its accumulated depreciation continue to be reported on balance sheet without future depreciation adjustment until company retires asset**
2. In **NO** situation can the accumulated depreciation on a plant asset exceed its cost

iv. Loss on Disposal

1. Company retires plant asset before it is fully depreciated
2. No cash is received for scrap or salvage value
3. Entry format
    a. Accumulated Depreciation – Equipment
    b. Loss on Disposal of Plant assets
        i. Equipment
            1. (To record retirement of delivery equipment at a loss)
4. Companies report Loss on disposal in the Other Expenses and Losses section of income statement

c. Sale of Plant assets

i. Disposal by sale

ii. Compare book value of asset with proceeds received from sale

iii. Proceeds of sale > book value= GAIN on disposal

iv. Proceeds of sale < book value = LOSS on disposal

v. Only by coincidence will book value = fair value when asset is sold

d. Gain on sale

i. Entry

- Depreciation Expense
    - Accumulated Depreciation –Equipment
        - (To Record depreciation expense for the first # months of #year)

ii. Calculation

1. Cost of office furniture
2. Less: Accumulated depreciation
3. Book value at date of disposal (Cost of office furn – acc dep)
4. Proceeds from Sale
5. Gain on disposal of plant asset (proceeds from sale – book value at date of disposal)

iii. Journalize

- Cash
- Accumulated Depreciation –Equipment
    - Equipment
    - Gain on disposal of Plant Assets
        - (To record sale of office furniture at a gain)

iv. Report Gain on Disposal in the Other Revenues and Gains section in income statement

e. Loss on Sale

i. Calculation Format

1. Cost of office furniture
2. Less: Accumulated Depreciation
3. Book value at date of disposal (cost of office furniture – acc dep)
4. Proceeds from sale
5. Loss on disposal of plant asset (book value – proceeds from sale)

ii. Journalize

- Cash
- Accumulated Depreciation –Equipment
- Loss on Disposal of Plant Assets
    - Equipment
        - (To record sale of office furniture at a loss)

iii. Companies report Loss on Disposal in Other Expenses and Losses section of income statement

V. 9.2: Natural Resources

a. Natural Resources: consist of standing timber and underground deposits of oil, gas, and minerals (long lived productive assets)

b. 2 characteristics

i. physically extracted in operations

ii. replaceable by nature

c. acquisition of nature resource: price needed to acquire the resource AND prepare for its intended use

d. depletion: allocation of the cost of natural resources to expense in a rational and systematic manner over the resource's useful life

i. depletion to natural resources

ii. depreciation to plant assets

e. Units of Activity Method

i. To measure depletion

ii. Bc depletion is a function of the units extracted during the year

iii. Formula

1. (Total cost – Salvage value) / Total Estimated Units = Depletion cost per unit

2. (Depletion cost per unit)(number of units extracted and sold) = annual depletion expense

iv. Journalize

- Depletion Expense
  - Accumulated Depletion (contra asset account)
    - (To record depletion expense on _____)

v. ex. Balance Sheet (partial)

1. Coal Mine

2. Less: Accumulated Depletion

vi. Company CR amount of depletion directly to natural resources account if it does NOT have accumulated depletion account

VI. 9.3: Intangible Assets

a. Intangible Assets: rights, privileges, and competitive advantages that result from the ownership of long lived assets that do not possess physical substance

b. Ex: contracts, licenses

c. Accounting

    i. Record at cost

    ii. Have limited life or indefinite life

    iii. Limited life: company allocates its cost over the asset's useful life using a process similar to depreciation (amortization)

        1. Amortization to intangibles
        2. Depreciation to plant assets
        3. Depletion to natural resources

    iv. Indefinite life: cost should not be amortized

d. To record Amortization

    i. DR Amortization Expense

    ii. CR specific intangible asset (there is NO contra account/accumulated amortization)

    iii. Typically amortized on a straight line basis

        1. Ex: legal life of patent = 20 yrs

2. Amortize the cost of the patent over its 20 yr life span or its useful life, whichever is SHORTER
3. Journalize
    - Amortization Expense (value = cost of patent/useful life)
        - Patents
            - (to record patent amortization)
4. Amortization Expense = operating expense in income statement
5. Cost for intangible asset ONLY INCLUDES THE PURCHASE PRICE

VII. Patents

a. Patent: exclusive right issued by the US patent office that enables the recipient to manufacture, sell, or otherwise control an invention for a period of 20 years from the date of the grant
    i. Nonrenewable
    ii. Can extend legal life of patent by obtaining new patents for improvements/changes in basic design
    iii. Initial cost of patent is the cash or cash equivalent price paid to acquire the patent
b. Need to defend patent
    i. Price you pay to defend it is included in the costs to the Patents Account and amortized over the remaining life of the patent

ii. Amortizes the cost of patent over its 20 yr legal life or useful life, whichever is SHORTER

iii. Obsolescence and inadequacy determines useful life

VIII. Copyrights

a. Copyrights: give the owner exclusive right to reproduce and sell an artistic or published work

b. Extend for the life of the creator plus 70 years

c. Cost of copyright = cost of acquiring and defending it

d. Amortized over a short period of time

IX. Trademarks and Trade Names

a. A word, phrase, jingle, symbol that identifies a particular enterprise or product

b. Creator/original user can obtain exclusive legal right by registering it with the US Patent Office

c. Registration provides 20 yrs of protection and CAN be renewed indefinitely as long as trademark/trade name is in use

d. Cost is the purchase price

e. Have indefinite life → NOT amortized

X. Franchises and Licenses

a. Franchise

i. A contractual arrangement between the franchisor and a franchise

    ii. Franchisor: grants the franchisee with the right to sell certain products, provide specific services, use certain trademarks or trade names within a designated geographic area

b. Licenses
    i. Another type of franchise entered between a governmental body and a company
    ii. Permits company to use public property in performing its services
    iii. Ex: city streets for bus line, public land for telephone/electric lines
c. Both can be granted for a definite period of time, indefinite period, or perpetually
d. Company can identify costs with the purchase of a franchise or license?
    i. Should recognize an intangible asset
    ii. Amortize the cost of a limited life franchise/license over its useful life
    iii. Life = indefinite: cost is not amortized
    iv. Annual payments made under franchise agreement are recorded as OPERATING EXPENSE in period in which they are occurred

XI. Goodwill
a. Largest intangible asset
b. Represents the value of all favorable attributes that relate to a company that are not attributable to any other specific asset
c. Ex: management, desirable location, good customer relations, skilled employees, etc

d. **UNLIKE ASSETS SUCH AS INVESTMENTS AND PLANT ASSETS WHICH CAN BE SOLD INDIVIDUALLY IN THE MARKETPLACE, GOODWILL CAN BE IDENTIFIED ONLY WITH THE BUSINESS AS A WHOLE!!**
e. **Companies record goodwill ONLY when an entire business is purchased**
    i. goodwill is the excess of cost over the fair value of the net assets (assets less liabilities) acquired
f. To record purchase of a business
    i. DR identifiable acquired assets
    ii. CR liabilities at their fair values
    iii. CR cash for purchase price
    iv. Records difference as Goodwill
g. Good will is NOT AMORTIZED bc it has indefinite life

XII. Research and Development Costs
a. Expenditures that may lead to patents, copyrights, new processes, and new products
b. Recorded as an expense when incurred, whether R/D is successful or not

XIII. 9.4: Presentation
a. Property Plant and Equipment: plant assets and natural resources
b. Intangibles are separately recorded
c. Disclose the major classes of assets such as land, building, and equipment and acc depreciation by major classes or in total
d. Describe the depreciation and amortization methods that were used
e. Disclose amount of depreciation and amortization expense for period

f. Ex1: Balance Sheet (partial)

    i. Property, Plant, and Equipment

        1. Buildings
        2. Machinery and equipment
        3. Land
        4. Accumulated depreciation

            a. Net property, plant, and equipment (add 1+2+3 and subtract 4)

    ii. Goodwill and other intangible assets

        1. Goodwill
        2. Trademarks and other intangible assets, net

            a. net goodwill and other intangible assets (add 1 and 2)

g. ex2: Balance Sheet (partial)

    i. Property, Plant, and Equipment

        1. Timberlands, at cost, less accumulated depletion (given)
        2. Building and equipment, at cost
        3. Less: accumulated depreciation (2 -3)

            a. Total property, plant, and equipment (2-3 + 1)

    ii. Intangibles

        1. Patents (given)

            a. Total (a +1)

XIV. Analysis

a. Asset turnover ratio: analyzes productivity of a company's assets

b. Tells how many dollars of sales a company generates for each dollar invested in assets

c. Formula: Net Sales / Average Total Assets = Asset Turnover Ratio

XV. Self Test Questions

a. The cost of equipment consists of the cash purchase price, freight charges, motor vehicle *licenses*, and accident *insurance* on company vehicles → false

b. The cost of land includes all of the following except

   i. Parking lots → except this! (land improvements which cr Land account)

   ii. Real estate brokers' commissions

   iii. Closing costs

   iv. Accrued property taxes

c. Recognizing depreciation on an asset results in an accumulation of cash for replacement of the asset → false

d. To determine the revised depreciation expense, the company computes the asset's depreciable cost at the time of the revision ad divides it by the asset's remaining useful life → true

e. ALWAYS CHECK THE DATES WHEN DETERMINING ACCUMULATED DEPRECIATION

f. Ordinary repairs → revenue expenditures

Jefferson Company purchased a piece of equipment on January 1, 2014. The equipment cost $60,000 and has an estimated life of 8 years and a salvage value of $8,000. What was the depreciation expense for the asset for 2015 under the double-declining-balance method?

(a) $6,500.
(b) $11,250.
(c) $15,000.
(d) $6,562.

Answer:

b. $11,250.

$\$ 60{,}000 \times 25\% = \$ 15{,}000; (\$ 60{,}000 - \$ 15{,}000) \times 25\% = \$ 11{,}250$

g.

Asks the depreciation expense for the asset in YEAR 2015. When you first do the calculation, it is for YEAR 2014. Must do the double declining balance method for 2 years.

h. When there is a change in estimated depreciation, current and future years' depreciation should be revised

Able Towing Company purchased a tow truck for $60,000 on January 1, 2012. It was originally depreciated c straight-line basis over 10 years with an assumed salvage value of $12,000. On December 31, 2014, before adjusting entries had been made, the company decided to change the remaining estimated life to 4 years (incl 2014) and the salvage value to $2,000. What was the depreciation expense for 2014?

(a) $6,000.
(b) $4,800.
(c) $15,000.
(d) $12,100.

Answer:

d. $12,100.

$[(\$ 60{,}000 - \$ 12{,}000) \div 10] \times 2 = \$ 9{,}600; (\$ 60{,}000 - \$ 9{,}600 - \$ 2{,}000) \div 4$

i.

j. additions to plant assets = capital expenditures k.

Maggie Sharrer Company expects to extract 20 million tons of coal from a mine that cost $12 million. If no salvage value is expected and 2 million tons are mined and sold in the first year, the entry to record depletion will include a:

(a) debit to Accumulated Depletion of $2,000,000.
(b) credit to Depletion Expense of $1,200,000.
(c) debit to Depletion Expense of $1,200,000.
(d) credit to Accumulated Depletion of $2,000,000.

Answer:

c. debit to Depletion Expense of $1,200,000.

($ 12 million ÷ 20 million) × 2 million

l. the amortization period of an intangible asset can exceed 20 years → true

m. research and development cost are expensed when incurred, except when the research and development expenditures result in a successful patent → false

n.

Martha Beyerlein Company incurred $150,000 of research and development costs in its laboratory to dev patent granted on January 2, 2014. On July 31, 2014, Beyerlein paid $35,000 for legal fees in a successfu defense of the patent. The total amount debited to Patents through July 31, 2014, should be:

(a) $150,000.
(b) $35,000.
(c) $185,000.
(d) $170,000.

Answer:

b. $35,000.

o. totals of major classes of assets can be shown in the balance sheet, with asset details disclosed in the notes to the financial statements → true

p.

Lake Coffee Company reported net sales of $180,000, net income of $54,000, beginning total assets of $200,000, and ending total assets of $300,000. What was the company's asset turnover ratio?

(a) 0.90
(b) 0.20
(c) 0.72
(d) 1.39

Answer:

c. 0.72

$ 180,000 ÷ [($ 200,000 + $ 300,000) ÷ 2]

Schopenhauer Company exchanged an old machine, with a book value of $39,000 and a fair value of $35,000, and paid $10,000 cash for a similar new machine. The transaction has commercial substance. At what amount should the machine acquired in the exchange be recorded on Schopenhauer's books?

(a) $45,000.

(b) $46,000.

(c) $49,000.

(d) $50,000.

Answer:

a. $45,000.

($ 35,000 + $ 10,000)

q.

r. in exchanges of assets in which the exchange has commercial substance, both gains and losses are recognized immediately

s. if it asks for the **annual** depreciation for the first and second years using the straight line method, state the value of how much the item depreciates each year. Example: truck worth 110. Salvage value of 10. Useful life is 4 years. 110-10 = 100. 100/4 = 25. The answer is 25, not 50.

Chapter 10: Liabilities

I. Current Liabilities

a. Current liability: a debt with 2 key features

i. Company reasonably expects to pay the debt from existing current assets or through the creation of other current liabilities

ii. Company will pay the debt within one year or the operating cycle, whichever is longer

iii. If they don't meet BOTH criteria → considered LONG TERM liabilities

iv. Include

1. Notes payable

2. Accounts payable
3. Unearned revenues
4. Accrued liabilities (taxes, salaries and wages, interest payable)

II. Notes Payable

- Obligations in the form of written notes
- Give lender formal proof of the obligation in case legal remedies are needed to collect the debt
- To meet short term financing needs
- borrower must pay interest
- those due for payment within 1 yr of the balance sheet date are usually classified as current liabilities

a. Journal Entry
    i. $100000 note
    ii. 12% 4 month note maturing on Jan 1
    iii. Format
        - Cash 100000
            - Notes Payable 100000
                - (to record insurance of 12%, 4 month note to _)

b. To calculate interest: (Face value of note)(annual interest rate)(time in terms of 1 yr)

c. Adjusting Entry (using the above example: 100000 x 12% x 4/12 = 4000)
    - Interest Expense 4000
        - Interest Payable 4000

        - (To accrue interest for 4 months on note)

d. Journalize when company pays face value of note + interest
   i. Notes Payable 100,000
   ii. Interest Payable 4,000
      1. Cash 104,000
         a. (to record payment of interest bearing note and accrued interest at maturity)

III. Sales Tax Payable
   a. Sales taxes are expressed as a percentage of the sales price
   b. Collect tax from the customer when the sale occurs
   c. Periodically (usu monthly), retailer remits the collections to the state's department of revenue
   d. Under law→ selling company must separately enter on cash register the amount of sale and amount of sales tax collected
      i. Exception: gasoline
   e. Format
      i. Sale: 10000
      ii. Sales tax: 600
      iii. (Sales tax rate: 6%)
      iv. Entry:
         - Cash 10,600
            - Sales Revenue 10,000
            - Sales Taxes Payable 600

- (To record daily sales and sales taxes)

f. company remits taxes to the taxing agency
    i. DR Sales Taxes Payable
    ii. CR Cash
    iii. Company does NOT report sales tax as expense
    iv. Company serves as a collection agent for the taxing authority

g. When company does NOT enter sales taxes separately on cash register
    i. Total receipts/100% + sales tax percentage
    ii. Ex: 10600/1.06 = 10,000
    iii. (1.06 is 100+6% which = 106% → 1.06)
    iv. Then determine sales tax amount: 10600 – 10000 = 600

IV. Payroll and Payroll Taxes Payable

a. Salaries and wages payable: salaries and wages owed to employees

b. Considered current liabilities bc these amounts must be paid to employees or remitted to taxing authorities in the near term → fines and penalties otherwise

c. Withholding taxes
    i. Amount required to be withheld from employee's gross pay
    ii. Until a company remits these withholding taxes to the governmental taxing authorities, they are CR to appropriate liability accounts
    iii. Ex: federal and state income taxes, SS taxes
    iv. Journal Format
        - Salaries and Wages Expense 10,000

- FICA Taxes Payable 7,650
- Federal Income Taxes Payable 21,864
- State Income Taxes Payable 2,922
- Salaries and Wages Payable 67,564
  - (To record payroll and withholding taxes for the week)

- Salaries and Wages Payable
  - Cash
    - (To record payment of #Date payroll)

v. payroll taxes:

1. the employer's share of SS taxes and the state and federal unemployment taxes
2. incurred liabilities with every payroll
3. Journal format (using same ex. Numbers)
   - Payroll Tax Expense
     - FICA Taxes Payable
     - Federal Unemployment Taxes Payable
     - Sales Unemployment Taxes Payable
       - (To record employer's payroll taxes on #date Payroll)

V. Unearned Revenues

a. Received before goods are delivered or before services are provided
b. Ex: season tickets, airplane companies, subscription magazines

c. When a company receives the advance payment
    i. DR cash
    ii. CR current liability account identifying the source of the unearned revenue
d. When company recognizes revenue
    i. DR unearned revenue account
    ii. CR revenue account
e. Journal Example (10,000 tickets sold for $50 each; 5 games)
    - Cash 500,000
        - Unearned Ticket Revenue 500,000
            - (To record sale of 10,000 season tickets)
f. After Each game is completed
    - Unearned Ticket Revenue
        - Ticket Revenue
            - (to record football ticket revenue)
g. Unearned Ticket Revenue
    i. Represents unearned revenue
    ii. As revenue is recognized → reclassified as Ticket Revenue
    iii. Type of business
        1. Airline → unearned ticket revenue → ticket revenue
        2. Magazine Publisher → unearned subscription rev →subscription rev.
        3. Hotel → unearned rent revenue → rent revenue

VI. Current Maturities of Long Term Debt

a. Portion of long term debt that comes due in the current year

b. Identified on balance sheet as long term debt due within 1 year

c. Not necessary to prepare adjusting entry to recognize current maturity of long term debt

d. Ex:

    i. 5 year interest bearing 25,000 note on Jan 1 2013

    ii. note specifies that each Jan 1, company should pay 5000 of note

    iii. company prepares financial statements on Dec 31

        1. report 5,000 as current liability

        2. report 20,000 as long term liability

VII. Statement Presentation and Analysis

a. Presentation

    i. Current liabilities = first category under Liabilities on balance sheet

    ii. Companies disclose terms of notes payable and other info in the Notes to the financial statements

b. NOT listed in order of liquidity

c. List by

    i. Order of Magnitude → largest account first

    ii. Notes Payable and then Accounts Payable, regardless of amount (then the remaining current liabilities are listed by magnitude)

    iii. Example Balance Sheet

        - Assets

        - Current Assets
        - Property Plant and Equipment (net)
        - Other Long Term assets
            - Total assets
    - Liabilities and Stockholder's Equity
        - Current Liabilities
            - Short Term borrowings (notes payable)
            - Accounts Payable
            - Accrued Expenses
            - Accrued wages, salaries, and employee benefits
            - Customer Advances
            - Dividends Payable
            - Other Current Liabilities
            - Long term debt due within 1 year
                - Total current liabilities
        - Noncurrent liabilities
            - Total liabilities
        - Stockholders' equity
            - Total liabilities and stockholders' equity

d. Analysis

    i. Liquidity: refers to the ability to pay maturing obligations and meet unexpected needs for cash

    ii. Working capital: excess of current assets over current liabilities (expressed in $ amount)
        1. Current Assets – Current Liabilities = Working capital
    iii. Current ratio: permits us to compare liquidity of different sized companies and of single company at different times
        1. Current Assets / Current liabilities = current ratio
        2. Historically: Current ratio 2:1 considered to be the standard for good credit rating
        3. Currently: many healthy companies have maintained lower ratios

VIII. 10.2: Long Term Liabilities
  a. obligations that are expected to be paid after one year
  b. obligations in the form of bonds or long term notes

IX. Bond Basics
  a. Bonds: form of interest bearing notes payable
  b. Companies decide between common stock or bonds to obtain large amounts of long term capital
  c. 3 advantages for bonds over common stock
    i. stockholder control is not affected: bondholders don't have voting rights; current owners (stockholders) retain full control of the company
    ii. tax savings result: bond interest is deductible for tax purposes; dividends on stock are not

        iii. earnings per share may be higher
            1. bond interest expense reduces net income
            2. earnings per share on c/s often is higher under bond financing
            3. no additional shares of common stock are issued
    d. disadvantage using bonds
        i. company must pay interest on a periodic basis
        ii. company must also repay the principal at the due date
    e. bonds sold in relatively small denominations (usu. $1000 multiples) → attract investors

X. Types of Bonds
    a. Secured and Unsecured
        i. Secured bonds: have specific assets of the issuer pledged as collateral for the bonds
            1. Mortgage bond: bond secured by real estate
            2. Sinking fund bond: bond secured by specific assets set aside to retire the bonds
        ii. Unsecured bonds (debenture bonds): issued against the general credit of the borrower
            1. Issued against the general credit of the borrower
            2. For companies with good credit ratings
    b. Term and Serial Bonds
        i. Term Bonds: Bonds that mature (due for payment) at a single specified future date

        ii. Serial bonds: bonds that mature in installments

    c. Registered and Bearer Bonds

        i. Registered bonds: bonds issued in the name of the owner

            1. interest payments are made by check to bondholders

            2. most bonds issued today

        ii. Bearer (coupon) bonds: bonds not registered

            1. Must send in coupons to receive interest payments

    d. Convertible and Callable Bonds

        i. Convertible bonds: bonds that can be converted into common stock at the bondholder's option

            1. Conversion feature is attractive

        ii. Callable bonds: bonds that the issuing company can retire at a stated dollar amount prior to maturity

XI. Issuing Procedures

    a. In authorizing the bond issue, the board of directors must stipulate the number of bonds to be authorized, total face value, and contractual interest rate

    b. Face value: the amount of principal the issuing company must pay at the maturity date

    c. Maturity date: the date that the final payment is due to the investor from the issuing company

    d. Contractual interest rate (stated rate): rate using to determine the amount of cash interest the borrower pas and the investor receives

        i. Usu. Stated as an annual rate
        ii. Usu. Paid semiannually
    e. Bond indenture: legal document where terms of bond issue are set
        i. Shows terms
        ii. Summarizes rights of bondholders and their trustees
        iii. Obligations of the issuing company
    f. Trustee
        i. Usu. Financial institution
        ii. Keeps records of each bondholder
        iii. Maintains custody of unissued bonds
        iv. Holds conditional title to pledged property
    g. Bond certificate:
        i. Printed by issuing company
        ii. Name of issuer
        iii. Face value
        iv. Contractual interest rate
        v. Maturity date
    h. Indenture and certificate are SEPARATE documents

XII. Bond Trading

    a. Bondholders have the opportunity to convert their holdings into cash at ANY time by selling the bonds at the CURRENT market price on national securities exchanges

b. Bond prices are quoted as a percentage of the face value of the bond, which is usually $1000
    i. Ex: $1000 bond with a quoted price of 97
    ii. The selling price of bond is 97% of face value → 970
c. Publish bond prices/trading activity DAILY
    i. Bonds
    ii. Maturity
    iii. Close
    iv. Yield
    v. Estimated volume (000)
d. Make journal entries only when it issues/buys back bonds or when bondholders convert bonds into common stock
    i. Company A sells Company X bonds to Company B. → company X does not record this transaction
    ii. Company B does keep record of names of bondholders in case of registered bonds

XIII. Determining the Market Price of Bonds
a. Zero interest bond: pays no interest
b. Time value of money: used to indicate the relationship between time and money- that a dollar received today is worth more than a dollar promised at some time in the future
c. Present value: the amount that must be invested today at a given rate of interest over a specified time

i. For bond – value at which it should sell in the market place

d. To determine Market Price – 3 factors to consider

i. The dollar amounts to be received

ii. The length of time until the amounts are received

iii. The market rate of interest

e. Market rate of interest: rate investors demand for loaning funds

XIV. Accounting for Bond Issues

a. Bonds can be issued

i. at face value

ii. below face value (discount)

iii. above face value (premium)

b. bond prices are quoted as percentage of the face value of the bond

c. face value is usually $1000

d. Issuing Bonds at face value

i. Example: issue $100,000 5 year, 10% bonds (100% of face value)

ii. Format

- Cash 100,000
    - Bonds Payable 100,000
        - (To record sale of bonds at face value)

e. To record interest on bonds payable

i. ex: interest is payable semiannually on Jan 1 and July 1

ii. using same numbers as prior example

1. 100,000 x 10% x 6/12 = 5000

2. Format (no previous accrual of interest)
    - Interest Expense 5000
        - Cash 5000
            - (To record payment of bond interest)

iii. Adjusting Entry (incurred since July 1)
- Interest Expense 5000
    - Interest Payable 5000
        - (To accrue bond interest)

iv. Companies classify interest payable as a current liability

f. To record payment on Jan 1

i. Interest Payable 5000
1. Cash 5000
    a. (To record payment of bond interest)

g. Discount on Premium Bonds

i. Contractual interest rate: rate applied to the face (par) value to arrive at the interest paid in a year

ii. Market interest rate: rate investors demand for loaning funds to the corporation

iii. When contractual interest rate and market interest rate are the same → bonds sell at face value (par value)

iv. Bonds can sell below or above face value

1. Discount: sold below face value → actual interest rate incurred by the company increases to the level of the current market interest rate
2. Premium: when bond is sold for more than face value → market rate of interest is lower than the contractual interest rate

h. Issuing Bonds at a discount

   i. Ex: sell 100,000 5 year 10% bonds for 92639 (92639 face value).
   ii. Interest payable on July 1 and Jan 1
   iii. Format
      1. Cash 92, 639 (carrying/book value)
      2. Discount on Bonds Payable 7361
         a. Bonds Payable 100,000
            i. (To record sale of bonds at a discount)
   iv. DISCOUNT ON BONDS PAYABLE HAS A DR BALANCE. IT IS A CONTRA ACCOUNT
      1. This account is deducted from bonds payable on balance sheet
      2. Balance sheet example
         a. Long Term Liabilities
            i. Bonds Payable
            ii. Less: Discount on Bonds payable

Chapter 11: Corporations: Organization, Stock Transactions, Dividends, and Retained Earnings

I. 11.1: The Corporate Form of Organization
    a. corporation: entity separate and distinct from its owners
    b. considered a legal entity → has rights and privileges of a person (exception: voting, holding public office, etc)
    c. classification
        i. purpose:
            1. profit (ex: mcdonalds, google, nike)
            2. not for profit (charitable, medical, educational purposes)
        ii. ownership:
            1. publicly held: may have thousands of stockholders; stock is traded on national securities exchange
            2. privately held: usually has only a few stockholders; does not offer stock to general public; smaller than publicly held
    d. Characteristics of a Corporation
        i. Separate legal existence: Acts of corporation's owners (stockholders) do not bind the corporation unless the owners are agents of the corporation
        ii. Limited liability for stockholders
            1. Liability of stockholders limited to their investment in corporation

2. Creditors have no legal claim on personal assets of owners unless fraud occurred
3. Bankruptcy? Stockholder's losses are limited to their capital investment in corporation
4. Only the corporation's assets are susceptible to claims

iii. Transferable Ownership Rights
1. Ownership in form of shares of capital stock
2. Stock is transferable
    a. Sell stock = way of disposing part/all of their interest in corp.
    b. Transfer: a transaction between individual owners
    c. Company does not participate in transfers after first issuance of stock

iv. Ability to acquire capital: the ability of a successful corporation to obtain capital is virtually unlimited

v. Continuous Life
1. Stated in its charter
2. Perpetual or limited to specific number of years
3. Can extend life through renewal of charter

vi. Corporation Management
1. Stockholders legally own the corporation, managed indirectly through board of directors that they elect
2. Hierarchy of management

a. CEO – Chief Executive Officer

    i. Chairman and Board of Directors

        1. President and Chief Executive Officer

            a. General Counsel/Secretary

            b. VP Marketing

            c. VP Finance/Chief Financial Officer

                i. Treasurer: custody of corporations funds, responsible for maintaining company's cash position

                ii. Controller (chief accounting officer): maintain accounting records, adequate system of Internal Control, Prepare financial statements, tax returns, and internal reports

            d. VP Operations

            e. VP Human Resources

vii. Government Regulations (for corporation)

    1. State laws → requirements for issuing stock, distribution of earnings, effects of retiring stocks

    2. Federal securities laws → govern scale of stock to the public

3. Publicly held corporations → extensive disclosure of their financial affairs to SEC through QUARTERLY AND ANNUAL reports

viii. Additional Taxes

1. Proprietor/partnership → report their share of earnings on their personal income tax returns and pays taxes on this amount
2. Corp → must pay federal and state income taxes as a SEPARATE legal entity
    a. Stockholders pay taxes on cash dividends (pro rata distributions of net income)
    b. Corporate income is taxed TWICE
        i. Once at corporate level
        ii. Once at individual level
3. Advantages vs Disadvantages of Corp VS Proprietorship/Partnership

Advantages	Disadvantages
Separate legal existence	Corporation management – separation of ownership and management
Limited liability of stockholders	Government regulations

Continuous life	Additional taxes (double taxation)
Transferable ownership rights	
Ability to acquire capital	
Corporation management – professional managers	

II. Forming a Corporation

a. Corporation is formed by grant of state charter
b. Charter: document that describes the name and purpose of the corporation, the types and number of shares of stock that are authorized to be issued, the names of the individuals that formed the company and the number of shares that these individuals agree to purchase
c. Corporation is incorporated in only ONE state regardless of the number of divisions
d. Should incorporate in a state whose laws are favorable to the corporate form of business organization
e. By laws: establish the internal rules and procedures for conducting the affairs of the corporation
f. License: subjects the corporation's operating activities to the general corporation laws of the state

        i. Companies engaged in interstate commerce must obtain a license from each state in which they do business

    g. Organization costs: costs incurred in the formation of a corporation
        i. Legal and state fees
        ii. Promotional expenditures
        iii. Expense organization costs AS INCURRED

III. Ownership Rights of Stockholders
    a. After being chartered, can sell stock
    b. Common stock: when corp. has only one class of stock; allows stockholders to gain ownership which includes
        i. Vote in Board of Directors and other entities
        ii. Share the corporate earnings though receipt of dividends
        iii. Keep the same percentage ownership when new shares of stock are issued (preemptive right)
        iv. Share in assets upon liquidation in proportion to their holdings (residual claim: owners are paid with assets that remain after all creditors' claims have been paid)
    c. Stock certificate: proof of stock ownership

IV. Stock Issue Considerations
    a. Authorized Stock
        i. Total amount of Authorized stock at time of incorporation normally anticipates both initial and subsequent capital needs

    ii. Number of shares authorized usually EXCEEDS the number initially sold
    iii. If all authorized stock is sold, corp. needs to obtain consent of state to amend its charter before issuing more shares
    iv. Authorization of stock does NOT result in a formal accounting entry (has NO immediate effect on either corporate assets of stockholder's equity)

b. Issuance of Stock
    i. Directly: typical in closely held companies
    ii. Indirectly:
        1. through investment banking form that specializes in bringing securities to the attention of prospective investors
        2. typical for a publicly held corporation
        3. investment firm may agree to UNDERWRITE the entire stock issue
            a. investment banker buys the stock at stipulated price and resells shares to investors
            b. corp. avoids any risk of being unable to sell the shares
            c. corp. can use the cash immediately
            d. investment banking firm receives an underwriting fee (for taking the risk)

c. Market Price of Stock

        i. Price per share is determined by the interaction between buyers and seller
        ii. Prices set by marketplace tend to follow the trend of a company's earnings and dividends
        iii. Trading of capital stock on securities exchanges involves the transfer of already issued shares from an existing stockholder to another investor → NO impact on a corp's stockholder's equity
    d. Par and No-Par Value Stocks
        i. Par value stock: capital stock to which the charter has assigned a value per share
        ii. No par value stock: capital stock to which the charter has not assigned a value
            1. Board of directors assign a stated value to no par shares

V. Corporate Capital
    a. Owner's equity (stockholders'/shareholders' equity or corporate capital)
    b. Stockholders' equity consists of 2 parts on balance sheet
        i. Paid in (contributed) capital:
            1. The total amount of cash and other assets paid in to the corporation by stockholders in exchange for capital stock
            2. cannot declare dividends
        ii. Retained earnings (earned capital):
            1. Net income that a corporation retains for future use

            2. Recorded: Close entry that DR income summary and CR Retained Earnings
            3. can declare dividends

VI. 11.2: Accounting for Stock Transactions

   a. Accounting for Common Stock Issues
      i. Objective
         1. Identify specific sources of paid in capital
         2. Maintain the distinction between paid in capital and retained earnings
      ii. Issuance of c/s affects only paid in capital accounts
   b. Issuing **Par** value common stock for cash
      i. Par value does NOT indicate stock's market price
      ii. Cash proceeds from issuing par value stock can be =/</> par value
      iii. Record issuance of C/s for cash
         1. DR Cash
         2. CR common stock the par value of the stares
      iv. Record the issuance of additional shares of par value c/s for cash
         1. DR Cash
         2. CR common stock
         3. CR paid in capital in excess of par-common stock
         4. ** when corp. issues stock for LESS than par value, DR Paid in capital in excess of par- common stock if a CR balance exists in this account**

5. **Cr balance does NOT exist → corp. DR Retained Earnings the amount less than par**

c. Issuing **No Par** Common Stock for Cash
    i. No par c/s has a stated value → entries are SIMILAR to par value stock
        1. DR Cash
        2. CR Common Stock
    ii. When the selling price exceeds stated value
        1. CR the excess to Paid in Capital in Excess of Stated Value – common stock
    iii. Stock does NOT have stated value
        1. CR the entire proceeds to C/S
d. Issuing C/S For services or noncash assets
    i. Comply with cost principle for Noncash transaction
        1. Cost is the cash equivalent price
        2. Cost is either the fair value of the consideration given up or the fair value of the consideration received
    ii. Format (stock given for a service)
        1. Organization Expense (EXPENSED AS INCURRED)
            a. Common Stock
            b. Paid in Capital in Excess of Par- Common stock
                i. (To record issuance of # shares of $ par value stock to _)

    iii. Format (stock given for land, with market price stated)
        1. Land
            a. Common Stock
            b. Paid in Capital in Excess of par- common stock
                i. (to record issuance of # shares of $ value stock for land)
    iv. THE PAR VALUE OF THE STOCK/STATED VALUE OF THE NO PAR STOCK IS NEVER A FACTOR IN DETERMINING THE COST OF THE ASSETS RECEIVED

VII. Accounting for Treasury Stock
- a. Treasury Stock: corporation's own stock that it has issued and subsequently reacquired from shareholders, but not retired; NOT an asset
- b. Acquired for reasons
    - i. To reissue the shares to officers and employees under bonus and stock compensation plans
    - ii. To signal to the stock market that management believes the stock is underpriced, hoping of enhancing its market price
    - iii. To have additional shares available for use in the acquisition of other companies
    - iv. To reduce the number of shares outstanding and thereby increase earnings per share
    - v. Management may want to eliminate hostile shareholders by buying them out

c. Purchase of treasury stock
    i. The cost method: uses the cost of the shares purchased to value the treasury stock
        1. DR Treasury Stock (for the price paid to reacquire the shares)
    ii. Dispose of shares
        1. CR Treasury Stock (the same amount it paid to reacquire the shares)
    iii. Treasury stock is a
        1. CONTRA STOCKHOLDERS' EQUITY ACCOUNT: meaning, if you obtain treasury stock, you reduce stockholders' equity
        2. Format: Less: Treasury Stock
        3. Deduction from total pain in capital and retained earnings
    iv. Outstanding stock: the number of shares of issued stock that are being held by stockholders
d. Disposal of Treasury Stock – sell above or below cost
    i. Sale of treasury stock increases both total assets and total stockholders' equity
    ii. Selling price of the treasury shares is equal to their cost
        1. DR cash
        2. CR Treasury Stock
    iii. Sold ABOVE cost
        1. DR Cash
        2. CR Treasury Stock

3. CR the difference to Paid in Capital from Treasury Stock

iv. Sold BEOW cost

1. DR cash
2. DR Paid in Capital from Treasury Stock
3. CR Treasury Stock

HELP WITH CHAPTER 11:

https://answers.yahoo.com/question/index?qid=20130119170409AAhyXlt