

## Review of Accounting Concepts

### Assets

Assets = items owned by the firm, valued at historic cost.  
Short-term Assets = items typically liquidated within 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

Assets = Liabilities + Equity

<u>Assets</u>	<u>Liabilities + Equity</u>
Cash	Accounts Payable ( <i>Pay</i> )
Accounts Receivable ( <i>Rec</i> )	Debt
Inventories ( <i>Inv</i> )	Stock
Property, Plant & Equipment ( <i>PP&amp;E</i> )	Retained Earnings
Intangible Assets	

## Income Statement Accounts

Revenues (*Rev*) = sales value of all items sold during the accounting period.

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

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

Undepreciated Book Value of Liquidated Assets (*UBV*) = book value of assets sold or scrapped during the accounting period.

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

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

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

Pretax Net Income (*PNI*) = Total Revenues minus Total Expenses, excluding Tax.

$$PNI = Rev - COGS - Dep - UBV - Int - SG\&A$$

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 or *Rec*, credit *Rev*. Also debit *UBV*, credit the asset account.

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.

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.