

Forms of Business

| 1. Sole Prop | 2. Partnership | 3. Corporation |
|--------------------|--------------------|-----------------------|
| Tax advantages | Tax advantages | Higher taxes |
| Easily formed | Skill of owners | Complex to organize |
| Owner control | Shared control | Easy transfer control |
| Personal liability | Personal liability | Limited liability |
| Limited life | Limited life | Easier to raise money |

Statement of Earnings = Income Statement

How well a business performs. Profit and loss.

| Net Income = Revenue | - Expenses |
|--|---|
| Rev = asset (cash) a company gets for a good or service. Recorded at delivery to customer. | Exp = cost of assets used or liabilities created during operations. |

Statement of Cash Flows

Changes in cash over time. In/outflows & related to:

| Operating | Investing | Financing |
|---------------------------|-------------------------|--------------------------------------|
| Running the business | Buy/sell LTA to run ops | Get capital to run business |
| Acc Rec (income) | Buy/sell P, P & E | Issuing CS, Bonds, Bank invests |
| Acc Pay (services, wages) | Lending \$ (loans) | Pay out Divs, Retire (pay back) Debt |

SCF informs investors & creditors and assess company's:

- Ability to produce future net cash inflows
- Ability to meet obligations and pay dividends
- Need for external financing
- Reasons for diffs btn NI & cash receipts
- SFP eval of effects of cash & noncash I & F transactions.

Cash vs Accrual Accounting

| Cash Basis | Accrual Basis |
|--|----------------------------------|
| = Rev recorded when cash received | = Rev recog when earned |
| = Exp recorded when cash paid | = Exp recog when incurred |

Accrual Basis Accounting

Periodicity, Revenue Recognition Principle, Matching Concept

- Done at end of accounting period, more meaningful comparisons btn companies & across time, predictive of future income

- Impacts 1(+) income statement account and 1 SFP account (not Cash Flow statement)

ACCRUED REVENUE = earned Rev, no cash received. Adj needed: record Rev & in A (AR). If not done: understated A (AR), Rev, NI, Profit

ACCRUED EXPENSE = incurred Exp, no cash is paid. Adj needed: record Exp & in L (AP). If not done: understated L (AP), Exp, overstated NI, SE, Profit

UNEARNED REVENUE = receive cash (in A), service not done (de L). Adj needed: record Rev & de L (unearned Rev). If not done: overstated L, understated Rev, NI, SE, Profit

PREPAID EXPENSE = cash is paid (de A, cash), service not received (in A, prepaid exp). Adj needed: record Exp & de A (prepaid Exp). If not done: overstated A, NI, SE, Profit, understated Exp.

Revenue Recognition can occur when the Rev and Exp is reliably measurable and the following has been transferred: managerial control, risks, economic benefits

Nature of Inventory

MERCHANDISER = purchase inv ready to sell

MANUFACTURER = Raw M-> WIP -> Fin Goods

Inventory = Asset, Expense = COGS

PERPETUAL INV SYSTEM = cont updated, records Rev & Cost at same time, more expensive, better for decision-making

PERIODIC INV SYSTEM = balance prod at end of accounting period w/ physical count, est using gross profit method, cheaper

Analyzing Inv: 2 main KPI = GP Ratio & Inv Turnover Ratio

Statement of Financial Position

Balances what co has with what it owes at specific point in time

Assets = Liabilities + Shareholder's Equity

Resources owned or controlled by company Obligations incurred & need to be settled. Creditor's claim Owners' residual interest in the company

CURRENT **CURRENT** Common Shares

Cash, supplies Salaries Retained Earnings

Accounts Receivable Accounts Payable - Revenue

Prepaid rent/ins Unearned Revenue - Expense

NON CURRENT **NON CURRENT** - Dividends

LTI (P, P & E) Loans

Intangible (e.g. patent) Notes, Bonds Payable

Statement of Changes in Equity

How much income was kept and how much was given to owners over a period of time

Retained Earnings (end) = RE (start) + Net Income - Dividends

Definitions

Account = records of in's & de's in each element of SFP

Net Income = Income from Ops - (Non-op Rev + Exp) - Income tax

Cost in Year = Inv(s) + Exp(net)

COGS = Inv(s) + Exp(net) - Inv(end)

Gross Profit (Margin) = Net Sales (Revenue) - Cost of Goods Sold

Income from Ops = Gross Margin - Op Exps

Cross Sectional Analysis = compares one corporation to another & to industry averages

Time series (Trend) Analysis = compares a corporation across time

Horizontal Analysis = SFP items are expressed as % of base yr (shows trends in time)

Vertical Analysis = SFP items are expressed as % of largest amount on SFP

Changes in SFP Accounts

| Classification | Cash Effect | SFP Affected | Example |
|----------------|-------------|--------------|--------------|
| Operating | Inflow (+) | de CA | Collect AR |
| | | in CL | Unearned rev |
| | Outflow (-) | in RE | Cash sale |
| | | in CA | Buy inv |
| Investing | Inflow (+) | de CL | Pay AP |
| | | de RE | Pay int |
| | Outflow (-) | de LTA | Sell equip |
| | | in LTA | Buy equip |
| Financing | Inflow (+) | in LTL | Issue debt |
| | | in SE | Issue CS |
| | Outflow (-) | de LTL | Repay debt |
| | | de SE | Pay Div |
| NC I & F | Inflow (+) | NC A | Deprec Exp |
| | Outflow (-) | NC Rev | |

Cash Flows Impact SFP

in CASH = in L + in SE + de NCA

de CASH = de L + de SE + in NCA



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