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Module 4
How to recognize transactions to the balance sheet

PAD 501

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Recording Financial Information

- A financial event is one that affects the fundamental accounting equation by changing any of its components:

  Assets = Liabilities + Net Assets

- A journal is a chronological listing of every financial event that occurs in an organization.

- Every type of asset, liability, revenue, or expense is referred to as an account. Organizations may have as many accounts as they need.

Recognizing Asset Transactions

- Financial events are recorded at the time of Recognition.

- Asset transactions are recognized when:
  - The assets are owned by the organization,
  - The assets have a monetary value,
  - That monetary value can be objectively determined.

- Which of the following should be recognized as assets?
  - The amount due on a bill sent to a client for a service provided?
  - An LCD computer projector that company has purchased 2 years ago?
  - A fundraising mailing list developed in an organization?

Plant and Equipment on the Balance Sheet

- Recorded at cost when acquired.
- Reported net of accumulated depreciation on the balance sheet.

- Suppose an organization buys a van for $30,000 and expects to use it for five years and sell it for $5,000. Assuming that the van will be used up evenly over the five years, how would its value appear on the balance sheet at the end of two years?

- 30,000 – 5,000 = 25,000, which is the total depreciation amount from year 0 to year five
- 25,000 / 5 = 5,000, which is the average yearly depreciation amount
- 5,000 * 2 = 10,000, which is the accumulative depreciation amount in the first two years
- 30,000 – 10,000 = 20,000, which is the value of the van at the end of the two years. therefore, at the end of year 2, the value of the van on the balance sheet is 20,000

Fixed Assets on the Balance Sheet

- All three values—cost, accumulated depreciation—and net book value are shown on the balance sheet or in notes that accompany the financial statements. Why?

	Museum A	Museum B
Net Fixed Assets or Net Book Value	$ 1,000,000	$ 1,000,000
PP&E at cost	$ 40,000,000	$ 2,000,000
Accumulated Depreciation	(39,000,000)	(1,000,000)
Net Book Value	$ 1,000,000	$ 1,000,000

Are these two museums really similar or different?

Liability Recognition

- Liabilities are recognized when:
  - They are legally owed,
  - Have to be paid, and
  - The amount to be paid can be measured objectively.

- Which of the following should be recognized as a liability?
  - A bill received from a vendor for a service received?
  - Wages that are due to a worker?

Practice transactions

- Following the case of Coho Adult Day Services (CADS), discuss how these transactions would affect CADS's balance sheet:
  - In August 2019, CADS received $35,000 from city's general fund.
  - In August 2019, CADS made an agreement with Coho Memorial Hospital. The hospital agreed to sell its building for $180,000 to CADS. CADS has not paid for the purchase.
  - In September 2019, CADS made a 30-year mortgage at 4.5% APR to purchase the building for $180,000. A 5% down payment is due at the purchase. The first mortgage payment is also due at the purchase.
  - In September 2019, CADS borrowed $40,000 from a local bank. The principal does not have to be paid back in two years. Interest expense for the loan is 3% APR.
  - In October 2019, CADS paid $500 for the bank loan ($100 is for interest).

Practice transactions

- In October 2019, CADS spent $10,000 to purchase equipment. CADS received the bill and will pay for it at the end of the year. CADS paid the $10,000 in full for the equipment.
- In October 2019, the salaries for staff are $20,000. Salaries are paid on a monthly basis, disbursed one week after the end of each month.
- The facility must be certified by the National Adult Day Services Association at a cost of $5,000/year. The certification fee is due in January 2020.
- The facility must carry $5,000,000 in hazard insurance coverage. Local insurance brokers offer that coverage for $2,500/month. In 2019, CADS pays in advance for the 2020 insurance fee.
- In January 2019, CADS bills the attendees $80,000 for their admission fees for 2019. They have not paid for the fees yet.
- In January 2019, CADS paid $2,000 to cover utility bills.

Transactions

- In August 2019, CADS received $35,000 from city's general fund.
  - Cash goes up by $35,000; net assets go up by $35,000
- In August 2019, CADS made an agreement with Coho Memorial Hospital. The hospital agreed to sell its building for $180,000 to CADS. CADS has not paid for the purchase.
  - No transaction, because the purchase has not taken place yet.
- In September 2019, CADS made a 30-year mortgage at 4.5% APR to purchase the building for $180,000. A 5% down payment is due at the purchase. The first mortgage payment is also due at the purchase.
  - Building (PP&E, Assets) goes up by $180,000; Cash goes down by $9,000 for down payment; Mortgage (Long-term liabilities) goes up by $171,000, which is purchase price minus down payment

Transactions

- In September 2019, CADS borrowed $40,000 from a local bank. The principal does not have to be paid back in two years. Interest expense for the loan is 3% APR.
  - Cash goes up by $40,000; Bank loan goes up by $40,000
- In October 2019, CADS paid $500 for the bank loan ($100 is for interest).
  - Cash goes down by $500; Bank loan goes down by $400; net assets go down by $100
- In October 2019, CADS spent $10,000 to purchase equipment. CADS received the bill and will pay for it at the end of the year.
  - Equipment goes up by $10,000; Account payable goes up by $10,000
- CADS paid the $10,000 in full for the equipment.
  - Cash goes down by $10,000; Account payable goes down by $10,000

Transactions

- In October 2019, the salaries for staff are $20,000. Salaries are paid on a monthly basis, disbursed one week after the end of each month.
  - Account payable (salary payable) reduced by $20,000. Note that I assume the salaries are earned in the previous period and has not paid until this month.
  - Net assets goes down by $20,000. The organization's net worth reduced by this amount because they spent this on salaries
- The facility must be certified by the National Adult Day Services Association at a cost of $5,000/year. The certification fee is due in January 2021.
  - No transaction is recorded because this is only a fee that will be due in the future. The organization is not yet legally obligated to pay this fee.

Transactions

- The facility must carry $5,000,000 in hazard insurance coverage. Local insurance brokers offer that coverage for $2,500/month. In 2019, CADS pays in advance for the 2020 insurance fee.
  - Cash goes down by $2,500 for the payment; prepaid goes up by $2,500 because of the service you paid in advance
- In January 2019, CADS bills the attendees $80,000 for their admission fees for 2019. They have not paid for the fees yet.
  - Account receivable increase by $80,000;
  - Net assets go up by $80,000 because of the revenues the organization has made
- In January 2019, CADS paid $2,000 to cover utility bills.
  - Cash goes down by $2,000
  - Net assets go down by $2,000 because of the expense spent on utility.