

# Financial accounting

## chapter 4



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Income Statement Reports revenues and expenses and calculates net income or net loss for the time period  
Statement of Retained Earnings Shows how retained earnings changed during the period due to net income (or net loss) and dividends  
Balance Sheet Reports assets, liabilities, and stockholders' equity as of the LAST DAY of the period  
Classified Balance Sheet A balance sheet that places each asset and each liability into a specific category  
Current Assets An asset that is expected to be converted to cash, sold, or used up during the next 12 months, or within the business's normal operating cycle  
Operating Cycle The time span when cash is used to acquire goods and services, the goods and services are sold to customers, then the business collects the cash from customers  
Long-Term Asset An asset that will not be converted to cash or used up within the business's operating cycle or one year, whichever is greater  
What three categories are long-term assets made up of? Long-term investments, plant assets, and intangible assets  
Long-Term Investments Investments in bonds or stocks in which the company intends to hold the investment for longer than one year  
Plant Assets Long-lived, tangible asset, such as land, buildings, and equipment, used in the operation of a business  
What's used in operating plant assets? Land, building, furniture, and equipment  
Plant assets are also called what? Fixed assets OR property, plant, and equipment  
How are plant assets presented? In order of liquidity  
Intangible Assets An asset with no physical form that is valuable because of the special rights it carries  
What are some examples of tangible assets? Patents, copyrights, and trademarks  
Current Liabilities A liability that must be paid with cash or with goods and services within one year or within the business's operating cycle  
What accounts are considered current liabilities? Accounts payable, notes payable (due within

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one year), salaries payable, interest payable, and unearned revenue How are current liabilities listed? By the order that they are due Long-Term Liabilities A liability that does not need to be paid within one year or within the business's operating cycle What account is considered a long-term liability? Notes payable Stockholders' Equity Represents the stockholders' claims to the assets of the business What accounts are included in income statements? ONLY revenue and expense accounts The revenues and expenses will be transferred to the income statement from where? The adjusted trial balance section What accounts are included in balance sheets? Assets, liabilities, and equity accounts EXCEPT revenue and expense accounts How do you compute net income (net loss)? Total revenues - total expenses When does a net loss occur? When expenses exceed revenues What does the closing process consist of? Journalizing and posting the closing entries to set revenues, expenses, income summary, and dividends balances to zero for the next period When does the closing process occur? At the end of the period Temporary Account An account that relates to a particular accounting period and is closed at the end of the period What is another name for a temporary account? Nominal account Permanent Account An account that is not closed at the end of the period Closing Entries Entries that transfer the revenues, expenses, and dividends to the retained earnings account to prepare the company's books for the next period Income Summary A temporary account into which revenues and expenses are transferred prior to their final transfer into What is the first step of closing temporary accounts? Make the revenue accounts equal zero via the income summary account In the first step of closing temporary accounts, what account is debited and what account is credited? Service revenue is debited, income

summary is credited

What is the second step of closing temporary accounts? Make expense accounts equal zero via the income summary account

In the second step of closing temporary accounts, what account is debited and what account is credited? Income summary will be debited, each expense will be credited

What is the third step of closing temporary accounts? Make the income summary amount equal zero via the retained earnings account

In the third step of closing temporary accounts, what account is debited and what account is credited? Income summary is debited, retained earnings is credited

What is the fourth step of closing temporary accounts? Make the dividends equal zero via the retained earnings account

In the fourth step of closing temporary accounts, what account is debited and what account is credited? Retained earnings is debited, dividends is credited

Once the closing entries are recorded and posted, what does the accounting cycle end with? A post-closing trial balance

Post-Closing Trial Balance

A list of accounts and their balances at the end of the period

What accounts appear on the post-closing trial balance? Assets, liabilities, common stock, and retained earnings (only permanent accounts)

Accounting Cycle

The process by which companies produce their financial statements for a specific period

What do steps 1-3 of the accounting cycle consist of? Journalizing transactions and posting to the accounts

What do steps 4-10 of the accounting cycle consist of? Adjusting the accounts, preparing financial statements, and closing the accounts

Current Ratio

Measures the company's ability to pay current liabilities from current assets

What is the current ratio equation?  $\text{Current ratio} = \frac{\text{total current assets}}{\text{total current liabilities}}$

Why does a company prefer to have a high current ratio? Because that means it has plenty of current assets to pay its current liabilities

An increased current ratio means what? Improvement in a

company's ability to pay its current debts A decreased current ratio means what? Deterioration in a company's ability to pay its current debts When is a current ratio considered low and risky? 1. 00 Reversing Entries Special journal entries that ease the burden of accounting transactions in a later period What are reversing entries used in conjunction with? Accrual-type adjustments

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