Outline for ETS Accounting Review

Financial Accounting

I. Accounting Concepts
   a. Assumptions
      i. Economic entity
      ii. Going concern
      iii. Monetary Unit
      iv. Periodicity
   b. Principles
      i. Historical Cost
      ii. Revenue Recognition
      iii. Matching
      iv. Full Disclosure
   c. Constraints
      i. Cost-Benefit
      ii. Materiality
      iii. Industry Practices
      iv. Conservatism

II. Accounting equation
   a. Assets
   b. Liabilities
   c. Owners’ equity
      i. Contributed capital
      ii. Retained earnings
         1. Revenue
         2. Expenses
         3. Distributions
III. Financial statements
   a. Income Statement
      i. Sales
         1. Less: sales returns & allowances
         2. Less: sales discounts
      ii. Net sales
      iii. Less: Cost of goods sold
           1. Beginning inventory
           2. Add: purchases
           3. Cost of goods available for sale
           4. Less: ending inventory
      iv. Gross Profit
      v. Less: operating expenses
      vi. Net income from operations
      vii. Add other income (e.g., interest income, rental income)
      viii. Net income before interest and taxes (NIBIT)
      ix. Less: Income taxes
      x. Less: interest expense
      xi. Net income

   b. Balance Sheet
      i. As of a particular Date
      ii. Assets
           1. Cash
           2. Accounts receivable
           3. Notes receivable
           4. Inventory
           5. Land, buildings, and equipment
           6. Accumulated depreciation
      iii. Liabilities
           1. Accounts payable
           2. Notes payable
           3. Equity
           4. Common stock
           5. Additional paid in capital
           6. Treasury stock
           7. # of shares issued and outstanding
c. Statement of changes in equity
   i. Common stock and preferred stock accounts
      1. Beginning balance
      2. Add: Additional investments
      3. Ending balance
   ii. Retained earnings
      1. Beginning balance
      2. Add: net income (revenue - expenses)
      3. Less: dividends paid
      4. Ending balance

d. Statement of cash flows
   i. Cash flow from operating activities
      1. Direct method
         a. Add: Cash received from customers
         b. Less: Cash paid to vendors
      2. Indirect method
         a. Net income
         b. Add: depreciation
         c. Add: decrease in receivables, inventory and prepaid expenses
         d. Add: increase in accounts payable and other current payables
         e. Less: increases in receivables, inventory, and prepaid expenses
         f. Less: decreases in accounts payable and other current payables
   ii. Cash flow from investing activities
      1. Add: Cash received from PP&E and investments sold
      2. Less: Cash paid for PP&E and investments purchased
   iii. Cash flow from financing activities
      1. Add: Proceeds from stock issue and sale of treasury stock
      2. Add: Money borrowed
      3. Less: Purchase of treasury stock
      4. Less: Dividends paid
      5. Less: Loans repaid
IV. Debits and credits
   a. Sum of the debits must equal the sum of the credits for all transactions.
   b. All accounts that are positive on the LEFT side (negative on the right side) of the
      accounting equation increase with DEBITS
      i. Assets—positive on the left side
      ii. Allowance for doubtful accounts—negative on the right side
      iii. Distributions—negative on the right side
      iv. Expenses—negative on the right side
      v. Treasury stock—negative on the right side
   c. All accounts that are positive on the RIGHT side (negative on the left side) of the
      accounting equation increase with CREDITS
      i. Liabilities—positive on the right side
      ii. Contributed capital—positive on the right side
      iii. Retained earnings—positive on the right side
      iv. Revenue—positive on the right side
      v. Accumulated depreciation—negative of the left side
   d. If an account increases with a debit, then it decreases with a credit
   e. If an account increases with a credit, then it decreases with a debit

V. Accruals and deferrals
   a. Accrued revenue
      i. Revenue earned before cash received
      ii. Earning process increases Accounts Receivable
   b. Accrued expenses
      i. Expense incurred before cash paid
      ii. Expense recognition increases Accounts Payable
   c. Deferred revenue
      i. Cash received before revenue earned
      ii. Increase Unearned revenue (liability) when cash received
   d. Deferred expenses
      i. Cash paid before expense incurred
      ii. Increase prepaid expense when cash paid

VI. Closing process and temporary accounts
   a. Permanent accounts are not closed
      i. Assets
      ii. Liabilities
      iii. Contributed capital (Common stock) and Retained earnings
   b. Temporary accounts are closed (reduced to $0) at the end of the period to retained earnings
      i. Revenues—increase retained earnings
      ii. Expenses—decrease retained earnings
      iii. Dividends (distributions)—decrease retained earnings
VII. Inventory costing methods
   a. Specific identification
      i. Cost of each item sold is directly traced to a particular item (e.g., airplanes, cars)
      ii. First-in-First-Out (FIFO)
          1. The oldest goods purchased are the first goods sold
          2. The oldest goods are sold—Cost of goods sold
          3. The newest goods are not sold—Ending inventory
      iii. Last-in-First-Out (LIFO)
          1. The newest goods purchased are the first goods sold
          2. The newest goods are sold—Cost of goods sold
          3. The oldest goods are not sold—Ending inventory
      iv. Weighted average
          1. All units deemed to cost the same
          2. Computation of cost per unit
             a. ($$ of goods available for sale)/(units available for sale)
          3. Units sold x Cost per unit = COGS
          4. Units in ending inventory x Cost per unit = Ending inventory

VIII. Depreciation
   a. Cost of an asset allocated to periods that benefit from the use of the asset
   b. Recognizing depreciation
      i. Decrease asset on balance sheet by increasing accumulated depreciation
      ii. Increase expenses on income statement by increasing depreciation expense
   c. Book value of an asset = Cost – Accumulated depreciation
   d. Straight-line depreciation = (cost – salvage value) / useful life in years

IX. Types of organizations
   a. Sole proprietorship
      i. One owner
      ii. Personable liability
   b. Partnership
      i. Multiple owners
      ii. Personal liability for all partnership debts and actions
      iii. Mutual agency
   c. Corporation
      i. Corporate characteristics
         1. Separate legal entity
         2. Continuity of life
         3. No mutual agency
         4. Limited liability
         5. Separation of ownership and management

X. Stock terminology
   a. Shares issued
   b. Treasury stock: Stock repurchased by a corporation
   c. Shares outstanding = shares issued – treasury stock
Managerial Accounting

I. Cost behavior
   a. Fixed cost
      i. Total cost remains constant
      ii. Cost per unit decreases as volume increases
   b. Variable cost
      i. Total cost increases as volume increases
      ii. Cost per unit remains constant
   c. Mixed cost
      i. A fixed cost plus a variable cost
      ii. E.g., an electric bill might be $20 + $2 per kwh
   d. Step cost
      i. Cost remains constant for a short period, then increases when you get to a certain volume.
      ii. E.g., One inspector can inspect up to 100 units of inventory. If you produce more than 100 units, you will have to hire a second inspector.

II. Cost classifications
   a. Direct vs. indirect costs
      i. Direct costs
         1. Can be traced directly to a product, service, or activity
         2. Direct materials (DM)
         3. Direct labor (DL)
      ii. Indirect costs (Overhead)
         1. Cannot be traced (or not practical to be traced) to a specific product, service, or activity
         2. Indirect materials (e.g., glue & nails used to hold furniture together)
         3. Indirect labor (e.g., production supervisor)
         4. Factory overhead (O/H) E.g., utilities, building maintenance, depreciation on building

III. Overhead application
   a. Variable vs. absorption costing
      i. Variable costing does not include fixed overhead
         1. Fixed overhead is NOT assigned to units produced
      ii. Absorption costing includes fixed overhead in the amount of overhead allocated to units produced
   b. Applying overhead
      i. Allocation base—the unit of measure used to assign overhead costs to products or services. Common allocation bases are DL$ or DL hours, machine hours.
      ii. Overhead costs / units of allocation base
   c. Actual vs. normal costing
      i. Actual costing uses actual DM, DL and O/H.
      ii. Normal costing uses actual DM and DL, and estimated O/H.
         1. Estimated overhead rate = (estimated O/H$)/(estimated O/H base)
IV. Activity based costing  
   a. Allocating indirect costs to cost objects based on activities that cause the cost to occur.  
   b. Cost drivers are the activities that cause costs to occur  

V. Product costing  
   a. Job order costing—costs accumulated by project (could be a single unit or a small batch of units)  
   b. Process costing—allocates total manufacturing costs equally to total units produced  
      i. Total cost / total equivalent units produced  

VI. Cost-volume-profit analysis (CVP)  
   a. Contribution margin per unit (CM) = Sales per unit – variable cost (VC) per unit  
   b. Contribution margin ratio (CMR) = CM per unit / Sales price per unit  
   c. Break-even point in units = Fixed cost (FC) / CM per unit  
   d. Break-even point in dollars = FC / CM ratio  
   e. Target profit in units= (FC + target profit) / CM per unit  
   f. Target profit in dollars = (FC + target profit) / CM ratio  
   g. Net income = Sales – variable costs – fixed costs
VII. Budgets
   a. Used for planning and control
   b. Master budget
      i. Operating budget
         1. Sales budget—sales volume
         2. Production budget—units needed to be produced based on expected sales and desired inventory levels
         3. Materials and labor budgets—amounts needed to meet production budget
      ii. Financial budget
         1. Cash budget

VIII. Standard costing
   a. Variances from material standards
      i. Price—standard price vs. actual price
      ii. Quantity—standard amount of material vs. actual amount used
   b. Variances from labor standards
      i. Rate—standard labor rate vs. actual labor rate
      ii. Usage—standard amount of labor vs. actual amount of labor used

IX. Pro forma financial statements

X. Relevant costing
   a. Only use costs that will change from one alternative to another
   b. Additional revenue from order
   c. Additional variable costs
   d. Avoidable fixed costs
   e. Sunk costs are not relevant. They occurred in the past and cannot be changed.
   f. Types of relevant costing decisions
      i. Special order (usually at less than the normal sales price)
      ii. Make (product in-house) or buy (from a supplier)
      iii. Add or delete a product line?
         1. Using excess capacity (or space)
         2. Creating excess capacity (or space)
      iv. Jointly producing two or more products

XI. Responsibility accounting
   a. Cost center—manager only has control over costs incurred
   b. Revenue center—manager only has control over level of revenues
   c. Profit center—manager has control over revenues and costs, but not amount invested
   d. Investment center—manager has control over revenues, costs, and amount invested