The Basics

1. Accounting Equation:

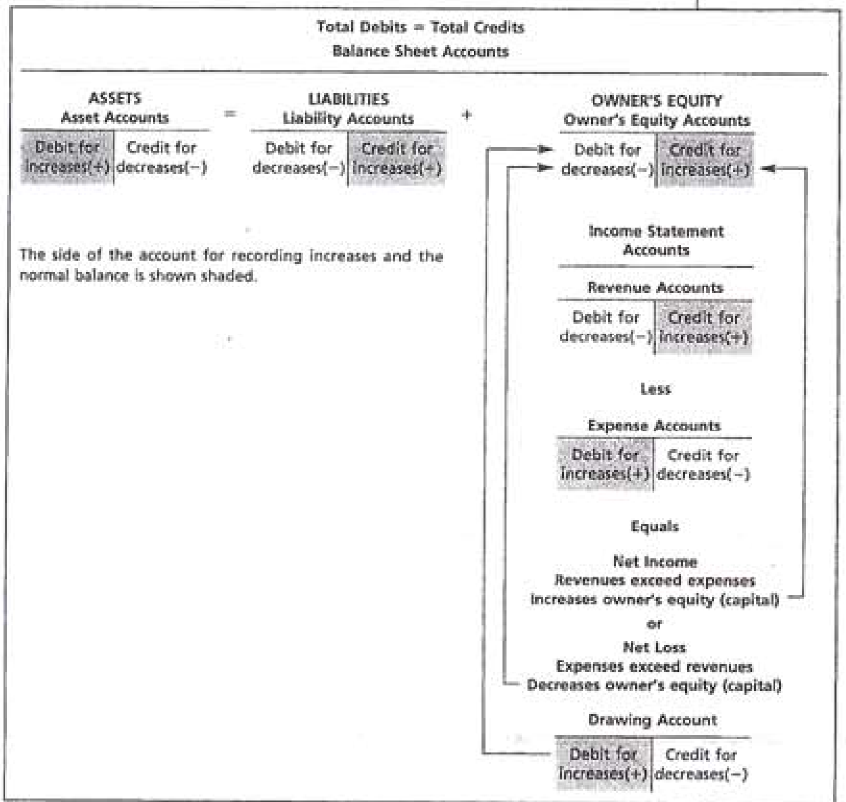
Assets = Liabilities + Owner's Equity

2. T Account:

Account Title

Left Side debit	Right Side credit

3. Rules of Debit and Credit:



4. Analyzing and Recording Transactions

1. Carefully read the description of the transaction to determine whether an asset, liability, owner's equity, revenue, expense, or drawing account is affected by the transaction.
2. For each account affected by the transaction, determine whether the account increases or decreases.
3. Determine whether each increase or decrease should be recorded as a debit or a credit.
4. Record the transaction using a journal entry.
5. Periodically post journal entries to the accounts in the ledger.
6. Prepare an unadjusted trial balance at the end of the period.

5. Financial Statements:

INCOME STATEMENT
A summary of the revenue and expenses of a business entity for a specific period of time, such as a month or a year.

STATEMENT OF OWNER'S EQUITY
A summary of the changes in the owner's equity of a business entity that have occurred during a specific period of time, such as a month or a year.

BALANCE SHEET
A list of the assets, liabilities, and owner's equity of a business entity as of a specific date, usually at the close of the last day of a month or a year.

STATEMENT OF CASH FLOWS
A summary of the cash receipts and cash payments of a business entity for a specific period of time, such as a month or a year.

6. Accounting Cycle:

1. Transactions are analyzed and recorded in the journal.
2. Transactions are posted to the ledger.
3. An unadjusted trial balance is prepared.
4. Adjustment data are assembled and analyzed.
5. An optional end-of-period spreadsheet (work sheet) is prepared.
6. Adjusting entries are journalized and posted to the ledger.
7. An adjusted trial balance is prepared.
8. Financial statements are prepared.
9. Closing entries are journalized and posted to the ledger.
10. A post-closing trial balance is prepared.

7. Types of Adjusting Entries:

1. Prepaid expense (deferred expense)
2. Unearned revenue (deferred revenue)
3. Accrued revenue (accrued asset)
4. Accrued expense (accrued liability)
5. Depreciation expense

Each entry will always affect both a balance sheet and an income statement account.

8. Closing Entries:

1. Transfer revenue account balances to Income Summary.
2. Transfer expense account balances to Income Summary.
3. Transfer Income Summary balance to Capital.
4. Transfer drawing account balance to Capital.

9. Special Journals:

Providing services on account ⟶ recorded in ⟶ Revenue (sales) journal
Receipt of cash from any source ⟶ recorded in ⟶ Cash receipts journal
Purchase of items on account ⟶ recorded in ⟶ Purchases journal
Payments of cash for any purpose ⟶ recorded in ⟶ Cash payments journal

10. Shipping Terms:

	FOB Shipping Point	FOB Destination
Ownership (title) passes to buyer when merchandise is....................	delivered to freight carrier	delivered to buyer
Transportation costs are paid by	buyer	seller

11. Format for Bank Reconciliation:

Cash balance according to bank statement		$xxx
Add: Additions by company not on bank statement	$xx	
Bank errors	xx	xx
		$xxx
Deduct: Deductions by company not on bank statement	$xx	
Bank errors	xx	xx
Adjusted balance		$xxx
Cash balance according to company's records		$xxx
Add: Additions by bank not recorded by company ..	$xx	
Company errors	xx	xx
		$xxx
Deduct: Deductions by bank not recorded by company	$xx	
Company errors	xx	xx
Adjusted balance		$xxx

12. Inventory Costing Methods:

1. First-in, First-out (FIFO)
2. Last-in, First-out (LIFO)
3. Average Cost

13. Interest Computations:

Interest = Face Amount (or Principal) × Rate × Time

14. Methods of Determining Annual Depreciation:

STRAIGHT-LINE: $\dfrac{\text{Cost – Estimated Residual Value}}{\text{Estimated Life}}$

DOUBLE-DECLINING-BALANCE: Rate* × Book Value at Beginning of Period

*Rate is commonly twice the straight-line rate (1/Estimated Life).

15. Adjustments to Net Income (Loss) Using the Indirect Method

	Increase (Decrease)
Net income (loss)	$ XXX
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation of fixed assets	XXX
Amortization of intangible assets	XXX
Losses on disposal of assets	XXX
Gains on disposal of assets	(XXX)
Changes in current operating assets and liabilities:	
Increases in noncash current operating assets	(XXX)
Decreases in noncash current operating assets	XXX
Increases in current operating liabilities	XXX
Decreases in current operating liabilities	(XXX)
Net cash flow from operating activities	$ XXX or $(XXX)

16. Contribution Margin Ratio = $\dfrac{\text{Sales – Variable Costs}}{\text{Sales}}$

17. Break-Even Sales (Units) = $\dfrac{\text{Fixed Costs}}{\text{Unit Contribution Margin}}$

18. Sales (Units) = $\dfrac{\text{Fixed Costs + Target Profit}}{\text{Unit Contribution Margin}}$

19. Margin of Safety = $\dfrac{\text{Sales – Sales at Break-Even Point}}{\text{Sales}}$

20. Operating Leverage = $\dfrac{\text{Contribution Margin}}{\text{Income from Operations}}$

21. Variances

Direct Materials Price Variance = (Actual Price per Unit – Standard Price) × Actual Quantity Used

Direct Materials Quantity Variance = (Actual Quantity Used – Standard Quantity) × Standard Price per Unit

Direct Labor Rate Variance = (Actual Rate per Hour – Standard Rate) × Actual Hours Worked

Direct Labor Time Variance = (Actual Hours Worked – Standard Hours) × Standard Rate per Hour

Variable Factory Overhead Controllable Variance = Actual Factory Overhead – Budgeted Factory Overhead for Amount Produced

Fixed Factory Overhead Volume Variance = Budgeted Factory Overhead for Amount Produced – Applied Factory Overhead

22. Rate of Return on Investment (ROI) = $\dfrac{\text{Income from Operations}}{\text{Invested Assets}}$

Alternative ROI Computation:

$$\text{ROI} = \frac{\text{Income from Operations}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Invested Assets}}$$

23. Capital Investment Analysis Methods:

1. Methods That Ignore Present Values:
   - A. Average Rate of Return Method
   - B. Cash Payback Method
2. Methods That Use Present Values:
   - A. Net Present Value Method
   - B. Internal Rate of Return Method

24. Average Rate of Return = $\dfrac{\text{Estimated Average Annual Income}}{\text{Average Investment}}$

25. Present Value Index = $\dfrac{\text{Total Present Value of Net Cash Flow}}{\text{Amount to Be Invested}}$

26. Present Value Factor for an Annuity of $1 = $\dfrac{\text{Amount to Be Invested}}{\text{Equal Annual Net Cash Flows}}$

Abbreviations and Acronyms Commonly Used in Business and Accounting

AAA	American Accounting Association
ABC	Activity-based costing
AICPA	American Institute of Certified Public Accountants
CIA	Certified Internal Auditor
CIM	Computer-integrated manufacturing
CMA	Certified Management Accountant
CPA	Certified Public Accountant
Cr.	Credit
Dr.	Debit
EFT	Electronic funds transfer
EPS	Earnings per share
FAF	Financial Accounting Foundation
FASB	Financial Accounting Standards Board
FEI	Financial Executives International
FICA tax	Federal Insurance Contributions Act tax
FIFO	First-in, first-out
FOB	Free on board
GAAP	Generally accepted accounting principles
GASB	Governmental Accounting Standards Board
GNP	Gross National Product
IMA	Institute of Management Accountants
IRC	Internal Revenue Code
IRS	Internal Revenue Service
JIT	Just-in-time
LIFO	Last-in, first-out
Lower of C or M	Lower of cost or market
MACRS	Modified Accelerated Cost Recovery System
n/30	Net 30
n/eom	Net, end-of-month
P/E Ratio	Price-earnings ratio
POS	Point of sale
ROI	Return on investment
SEC	Securities and Exchange Commission
TQC	Total quality control

Classification of Accounts

Account Title	*Account Classification*	*Normal Balance*	*Financial Statement*
Accounts Payable	Current liability	Credit	Balance sheet
Accounts Receivable	Current asset	Debit	Balance sheet
Accumulated Depreciation	Contra fixed asset	Credit	Balance sheet
Accumulated Depletion	Contra fixed asset	Credit	Balance sheet
Advertising Expense	Operating expense	Debit	Income statement
Allowance for Doubtful Accounts	Contra current asset	Credit	Balance sheet
Amortization Expense	Operating expense	Debit	Income statement
Bonds Payable	Long-term liability	Credit	Balance sheet
Building	Fixed asset	Debit	Balance sheet
________ Capital	Owner's equity	Credit	Statement of owner's equity/ Balance sheet
Capital Stock	Stockholders' equity	Credit	Balance sheet
Cash	Current asset	Debit	Balance sheet
Cash Dividends	Stockholders' equity	Debit	Retained earnings statement
Cash Dividends Payable	Current liability	Credit	Balance sheet
Common Stock	Stockholders' equity	Credit	Balance sheet
Cost of Merchandise (Goods) Sold	Cost of merchandise (goods sold)	Debit	Income statement
Deferred Income Tax Payable	Current liability/Long-term liability	Credit	Balance sheet
Depletion Expense	Operating expense	Debit	Income statement ✓
Discount on Bonds Payable	Long-term liability	Debit	Balance sheet
Dividend Revenue	Other income	Credit	Income statement
Dividends	Stockholders' equity	Debit	Retained earnings statement
________ Drawing	Owner's equity	Debit	Statement of owner's equity
Employees Federal Income Tax Payable	Current liability	Credit	Balance sheet
Equipment	Fixed asset	Debit	Balance sheet
Exchange Gain	Other income	Credit	Income statement
Exchange Loss	Other expense	Debit	Income statement
Factory Overhead (Overapplied)	Deferred credit	Credit	Balance sheet (interim)
Factory Overhead (Underapplied)	Deferred debit	Debit	Balance sheet (interim)
Federal Income Tax Payable	Current liability	Credit	Balance sheet
Federal Unemployment Tax Payable	Current liability	Credit	Balance sheet
Finished Goods	Current asset	Debit	Balance sheet
Gain on Disposal of Fixed Assets	Other income	Credit	Income statement
Gain on Redemption of Bonds	Other income	Credit	Income statement
Gain on Sale of Investments	Other income	Credit	Income statement
Goodwill	Intangible asset	Debit	Balance sheet
Income Tax Expense	Income tax	Debit	Income statement
Income Tax Payable	Current liability	Credit	Balance sheet
Insurance Expense	Operating expense	Debit	Income statement
Interest Expense	Other expense	Debit	Income statement
Interest Receivable	Current asset	Debit	Balance sheet
Interest Revenue	Other income	Credit	Income statement
Investment in Bonds	Investment	Debit	Balance sheet
Investment in Stocks	Investment	Debit	Balance sheet
Investment in Subsidiary	Investment	Debit	Balance sheet
Land	Fixed asset	Debit	Balance sheet
Loss on Disposal of Fixed Assets	Other expense	Debit	Income statement
Loss on Redemption of Bonds	Other expense	Debit	Income statement
Loss on Sale of Investments	Other expense	Debit	Income statement
Marketable Securities	Current asset	Debit	Balance sheet
Materials	Current asset	Debit	Balance sheet

Account Title	Account Classification	Normal Balance	Financial Statement
Medicare Tax Payable	Current liability	Credit	Balance sheet
Merchandise Inventory	Current asset/Cost of merchandise sold	Debit	Balance sheet/Income statement
Notes Payable	Current liability/Long-term liability	Credit	Balance sheet
Notes Receivable	Current asset/Investment	Debit	Balance sheet
Organizational Expenses	Operating expense	Debit	Income statement
Patents	Intangible asset	Debit	Balance sheet
Paid-In Capital from Sale of Treasury Stock	Stockholders' equity	Credit	Balance sheet
Paid-In Capital in Excess of Par (Stated Value)	Stockholders' equity	Credit	Balance sheet
Payroll Tax Expense	Operating expense	Debit	Income statement
Pension Expense	Operating expense	Debit	Income statement
Petty Cash	Current asset	Debit	Balance sheet
Premium on Bonds Payable	Long-term liability	Credit	Balance sheet
Prepaid Insurance	Current asset	Debit	Balance sheet
Prepaid Rent	Current asset	Debit	Balance sheet
Preferred Stock	Stockholders' equity	Credit	Balance sheet
Purchases	Cost of merchandise sold	Debit	Income statement
Purchases Discounts	Cost of merchandise sold	Credit	Income statement
Purchases Returns and Allowances	Cost of merchandise sold	Credit	Income statement
Rent Expense	Operating expense	Debit	Income statement
Rent Revenue	Other income	Credit	Income statement
Retained Earnings	Stockholders' equity	Credit	Balance sheet/Retained earnings statement
Salaries Expense	Operating expense	Debit	Income statement
Salaries Payable	Current liability	Credit	Balance sheet
Sales	Revenue from sales	Credit	Income statement
Sales Discounts	Revenue from sales	Debit	Income statement
Sales Returns and Allowances	Revenue from sales	Debit	Income statement
Sales Tax Payable	Current liability	Credit	Balance sheet
Sinking Fund Cash	Investment	Debit	Balance sheet
Sinking Fund Investments	Investment	Debit	Balance sheet
Social Security Tax Payable	Current liability	Credit	Balance sheet
State Unemployment Tax Payable	Current liability	Credit	Balance sheet
Stock Dividends	Stockholders' equity	Debit	Retained earnings statement
Stock Dividends Distributable	Stockholders' equity	Credit	Balance sheet
Supplies	Current asset	Debit	Balance sheet
Supplies Expense	Operating expense	Debit	Income statement
Transportation In	Cost of merchandise sold	Debit	Income statement
Transportation Out	Operating expense	Debit	Income statement
Treasury Stock	Stockholders' equity	Debit	Balance sheet
Uncollectible Accounts Expense	Operating expense	Debit	Income statement
Unearned Rent	Current liability	Credit	Balance sheet
Utilities Expense	Operating expense	Debit	Income statement
Vacation Pay Expense	Operating expense	Debit	Income statement
Vacation Pay Payable	Current liability/Long-term liability	Credit	Balance sheet
Work in Process	Current asset	Debit	Balance sheet