The Basics

1. **Accounting Equation:**
   
   Assets = Liabilities + (Stockholders’ Equity) Owner’s Equity

2. **T Account:**
   
<table>
<thead>
<tr>
<th>Account Title</th>
<th>Left Side</th>
<th>Right Side</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>debit</td>
<td>credit</td>
</tr>
</tbody>
</table>

3. **Rules of Debit and Credit:**

4. **Analyzing and Journalizing Transactions**

   1. Carefully read the description of the transaction to determine whether an asset, liability, capital stock, retained earnings, revenue, expense, or dividends 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, following the rules of debit and 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.

   **RETAINED EARNINGS STATEMENT**
   
   A summary of the changes in the retained earnings 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 stockholders’ equity of a business entity as of a specific date, usually at the close of the last day of 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 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. Revenue account balances are transferred to an account called Income Summary.
   2. Expense account balances are transferred to an account called Income Summary.
   3. The balance of Income Summary (net income or net loss) is transferred to Retained Earnings.
   4. The balance of the owner’s drawing account is transferred to Retained Earnings.

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:**

<table>
<thead>
<tr>
<th>Ownership (title)</th>
<th>FOB Shipping Point</th>
<th>FOB Destination</th>
</tr>
</thead>
<tbody>
<tr>
<td>passes to buyer when merchandise is delivered to freight carrier</td>
<td>delivered to buyer</td>
<td>delivered to seller</td>
</tr>
<tr>
<td>Freight costs are paid by</td>
<td>buyer</td>
<td>seller</td>
</tr>
</tbody>
</table>
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
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
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: Cost – Estimated Residual Value / 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

<table>
<thead>
<tr>
<th>Increase (Decrease)</th>
<th>Net income (loss) $ XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Adjustments to reconcile net income to net cash flow from operating activities:</td>
</tr>
<tr>
<td></td>
<td>Depreciation of fixed assets XXX</td>
</tr>
<tr>
<td></td>
<td>Amortization of intangible assets XXX</td>
</tr>
<tr>
<td></td>
<td>Losses on disposal of assets XXX</td>
</tr>
<tr>
<td></td>
<td>Gains on disposal of assets (XXX)</td>
</tr>
<tr>
<td></td>
<td>Changes in current operating assets and liabilities:</td>
</tr>
<tr>
<td></td>
<td>Increases in noncash current operating assets (XXX)</td>
</tr>
<tr>
<td></td>
<td>Decreases in noncash current operating assets XXX</td>
</tr>
<tr>
<td></td>
<td>Increases in current operating liabilities XXX</td>
</tr>
<tr>
<td></td>
<td>Decreases in current operating liabilities (XXX)</td>
</tr>
<tr>
<td></td>
<td>Net cash flow from operating activities $ XXX</td>
</tr>
</tbody>
</table>

16. Contribution Margin Ratio = Sales – Variable Costs / Sales

17. Break-Even Sales (Units) = 
\[
\frac{\text{Fixed Costs}}{\text{Unit Contribution Margin}}
\]

18. Sales (Units) = 
\[
\text{Fixed Costs} + \text{Target Profit} \div \text{Unit Contribution Margin}
\]

19. Margin of Safety = Sales – Sales at Break-Even Point / Sales

20. Operating Leverage = 
\[
\frac{\text{Contribution Margin}}{\text{Income from Operations}}
\]

21. Variances
Direct Materials Price Variance = (Actual Price – Standard Price) × Actual Quantity
Direct Materials Quantity Variance = (Actual Quantity – Standard Quantity) / Standard Price
Direct Labor Rate Variance = (Actual Rate per Hour – Standard Rate per Hour) × Actual Hours
Direct Labor Time Variance = (Actual Direct Labor Hours – Standard Rate per Hour) / Standard Rate per Hour
Variable Factory Overhead Controllable Variance = Actual Variable Overhead – Budgeted Variable Factory Overhead
Fixed Factory Overhead Volume Variance = Standard Hours for 100% of Normal Capacity – Standard Hours for Actual Units / Standard Rate per Hour
Fixed Factory Overhead Rate Variance = Standard Rate for 100% of Normal Capacity / Standard Rate per Hour

22. Rate of Return on Investment (ROI) = Income from Operations / 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 = Estimated Average Annual Income of Return / Average Investment

25. Present Value Index = Total Present Value of Net Cash Flow / Amount to Be Invested

26. Present Value Factor for an Annuity of $1 = Amount to Be Invested / Equal Annual Net Cash Flows