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ACCOUNTING PRINCIPLES 11e



RAPID REVIEW
Chapter Content

RESPONSIBILITY ACCOUNTING (Chapter 24)

Types of Responsibility Centers

Cost	Profit	Investment
Expenses only	Expenses and Revenues	Expenses and Revenues and ROI

Return on Investment

Return on investment (ROI) = Investment center controllable margin ÷ Average investment center operating assets

STANDARD COSTS (Chapter 25)

Standard Cost Variances

Total materials variance = Materials price variance + Materials quantity variance

Total labor variance = Labor price variance + Labor quantity variance

Total overhead variance = Overhead controllable variance + Overhead volume variance

Materials price variance = AQ × AP − AQ × SP

Materials quantity variance = AQ × SP − SQ × SP

Labor price variance = AH × AR − AH × SR

Labor quantity variance = AH × SR − SH × SR

Overhead variance = Actual overhead − Overhead applied

INCREMENTAL ANALYSIS AND CAPITAL BUDGETING (Chapter 26)

Incremental Analysis

1. Identify the relevant costs associated with each alternative. Relevant costs are those costs and revenues that differ across alternatives. Choose the alternative that maximizes net income.
2. Opportunity costs are those benefits that are given up when one alternative is chosen instead of another one. Opportunity costs are relevant costs.
3. Sunk costs have already been incurred and will not be changed or avoided by any future decision. Sunk costs are not relevant costs.

Annual Rate of Return

Annual rate of return = Expected annual net income ÷ Average investment

Cash Payback

Cash payback period = Cost of capital investment ÷ Net annual cash flow

Discounted Cash Flow Approaches

Net Present Value	Internal Rate of Return
Compute net present value (a dollar amount). If net present value is zero or positive, accept the proposal. If net present value is negative, reject the proposal.	Compute internal rate of return (a percentage). If internal rate of return is equal to or greater than the minimum required rate of return, accept the proposal. If internal rate of return is less than the minimum rate, reject the proposal.

RAPID REVIEW
Financial Statements

Order of Preparation

Statement Type	Date
1. Income statement	For the period ended
2. Retained earnings statement	For the period ended
3. Balance sheet	As of the end of the period
4. Statement of cash flows	For the period ended

Income Statement (perpetual inventory system)

COMPANY NAME
Income Statement
For the Period Ended

Sales revenues		
Sales revenue	$ X	
Less: Sales returns and allowances	X	
Sales discounts	X	
Net sales		$ X
Cost of goods sold		X
Gross profit		X
Operating expenses		
(Examples: store salaries, advertising, delivery, rent, depreciation, utilities, insurance)		X
Income from operations		X
Other revenues and gains		
(Examples: interest, gains)	X	
Other expenses and losses		
(Examples: interest, losses)	X	X
Income before income taxes		X
Income tax expense		X
Net income		$ X

Income Statement (periodic inventory system)

COMPANY NAME
Income Statement
For the Period Ended

Sales revenues			
Sales revenue		$ X	
Less: Sales returns and allowances		X	
Sales discounts		X	
Net sales			$ X
Cost of goods sold			
Beginning inventory		X	
Purchases	$ X		
Less: Purchase returns and allowances	X		
Net purchases	X		
Add: Freight-in	X		
Cost of goods purchased		X	
Cost of goods available for sale		X	
Less: Ending inventory		X	
Cost of goods sold			X
Gross profit			X
Operating expenses			
(Examples: store salaries, advertising, delivery, rent, depreciation, utilities, insurance)			X
Income from operations			X
Other revenues and gains			
(Examples: interest, gains)		X	
Other expenses and losses			
(Examples: interest, losses)		X	X
Income before income taxes			X
Income tax expense			X
Net income			$ X

Retained Earnings Statement

COMPANY NAME
Retained Earnings Statement
For the Period Ended

Retained earnings, beginning of period	$ X
Add: Net income (or deduct net loss)	X
	X
Deduct: Dividends	X
Retained earnings, end of period	$ X

STOP AND CHECK: Net income (loss) presented on the retained earnings statement must equal the net income (loss) presented on the income statement.

Balance Sheet

COMPANY NAME
Balance Sheet
As of the End of the Period

Assets

Current assets			
(Examples: cash, short-term debt investments, accounts receivable, inventory, prepaids)			$ X
Long-term investments			
(Examples: investments in bonds, investments in stocks)			X
Property, plant, and equipment			
Land		$ X	
Buildings and equipment	$ X		
Less: Accumulated depreciation	X	X	X
Intangible assets			X
Total assets			$ X

Liabilities and Stockholders' Equity

Liabilities	
Current liabilities	
(Examples: notes payable, accounts payable, accruals, unearned revenues, current portion of notes payable)	$ X
Long-term liabilities	
(Examples: notes payable, bonds payable)	X
Total liabilities	X
Stockholders' equity	
Common stock	X
Retained earnings	X
Total liabilities and stockholders' equity	$ X

STOP AND CHECK: Total assets on the balance sheet must equal total liabilities and stockholders' equity; and, ending retained earnings on the balance sheet must equal ending retained earnings on the retained earnings statement.

Statement of Cash Flows

COMPANY NAME
Statement of Cash Flows
For the Period Ended

Cash flows from operating activities	
(*Note:* May be prepared using the direct or indirect method)	
Net cash provided (used) by operating activities	$ X
Cash flows from investing activities	
(Examples: purchase / sale of long-term assets)	
Net cash provided (used) by investing activities	X
Cash flows from financing activities	
(Examples: issue / repayment of long-term liabilities, issue of stock, payment of dividends)	
Net cash provided (used) by financing activities	X
Net increase (decrease) in cash	X
Cash, beginning of the period	X
Cash, end of the period	$ X

STOP AND CHECK: Cash, end of the period, on the statement of cash flows must equal cash presented on the balance sheet.

RAPID REVIEW

Using the Information in the Financial Statements

	Ratio	Formula	Purpose or Use
	Liquidity Ratios		
1.	Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	Measures short-term debt-paying ability.
2.	Acid-test (quick) ratio	$\frac{\text{Cash + Short-term investments + Accounts receivable (net)}}{\text{Current liabilities}}$	Measures immediate short-term liquidity.
3.	Accounts receivable turnover	$\frac{\text{Net credit sales}}{\text{Average net accounts receivable}}$	Measures liquidity of receivables.
4.	Inventory turnover	$\frac{\text{Cost of goods sold}}{\text{Average inventory}}$	Measures liquidity of inventory.
	Profitability Ratios		
5.	Profit margin	$\frac{\text{Net income}}{\text{Net sales}}$	Measures net income generated by each dollar of sales.
6.	Asset turnover	$\frac{\text{Net sales}}{\text{Average total assets}}$	Measures how efficiently assets are used to generate sales.
7.	Return on assets	$\frac{\text{Net income}}{\text{Average total assets}}$	Measures overall profitability of assets.
8.	Return on common stockholders' equity	$\frac{\text{Net income} - \text{Preferred dividends}}{\text{Average common stockholders' equity}}$	Measures profitability of owners' investment.
9.	Earnings per share (EPS)	$\frac{\text{Net income} - \text{Preferred dividends}}{\text{Weighted-average common shares outstanding}}$	Measures net income earned on each share of common stock.
10.	Price-earnings (P-E) ratio	$\frac{\text{Market price per share of stock}}{\text{Earnings per share}}$	Measures ratio of the market price per share to earnings per share.
11.	Payout ratio	$\frac{\text{Cash dividends}}{\text{Net income}}$	Measures percentage of earnings distributed in the form of cash dividends.
	Solvency Ratios		
12.	Debt to assets ratio	$\frac{\text{Debt}}{\text{Assets}}$	Measures percentage of total assets provided by creditors.
13.	Times interest earned	$\frac{\text{Income before income taxes and interest expense}}{\text{Interest expense}}$	Measures ability to meet interest payments as they come due.
14.	Free cash flow	Net cash provided by operating activities − Capital expenditures − Cash dividends	Measures the amount of cash generated during the current year that is available for the payment of additional dividends or for expansion.