ALFRED NOBEL UNIVERSITY,
DNIPROPETROVS'K

V.M. Shevchenko

ACCOUNTING IN FOREIGN COUNTRIES

COURSE BOOK

ALFRED NOBEL UNIVERSITY,
DNIPROPETROVS'K

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ACCOUNTING IN FOREIGN COUNTRIES:

COURSE BOOK

TEXTBOOK

Dnipropetrovs'k
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Ш 37

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Навчальний посібник «Облік у зарубіжних країнах: практикум» спрямовано на вивчення методів і процедур, що використовуються у бухгалтерському обліку підприємств у зарубіжних країнах.

Посібник складено відповідно до навчального плану дисципліни «Бухгалтерський облік у зарубіжних країнах» для економічних напрямів. Він складається з 7 блоків. Кожен блок містить питання для обговорення, тести і завдання для самостійної роботи.

Використання навчального посібника в навчальному процесі дозволить ефективно застосувати набуті знання та навички, а також професійні компетенції у сфері бухгалтерського обліку.

Shevchenko V.M.

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The textbook «Accounting in Foreign Countries: course book» is aimed at the study of methods and procedures used in accounting of businesses in foreign countries.

The textbook has been compiled in accordance with the syllabus of the course «Accounting in Foreign Countries» for the economic directions of study. The textbook consists of 7 units. Each unit includes questions for discussion, tests and assignments for independent work.

Its use in the educational process will enhance both learning and effective application of the acquired knowledge and skills as well as professional competences in accounting.

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INTRODUCTION

Accounting provides a system of rules and principles that prescribe the format and content of financial statements. Through this consistent reporting, a company's managers and investors can assess the financial health of the firm.

The textbook «Accounting in Foreign Countries: course book» will help students to understand the role of accounting in management of the international activity of an enterprise in foreign countries and make management decisions in business processes. This textbook examines the principal issues concerning concepts, methods and procedures used in accounting of an enterprise in foreign countries. These include the nature and development of accounting principles, accounting terminology and underlying concepts. Topics to be covered include overview of the accounting process and procedures of accounting for preparing the balance sheet of enterprises in foreign countries.

The main aims of the course «Accounting in Foreign Countries» are to give students basic working knowledge about the structure of accounting in foreign counties; help the students develop sufficient understanding of basic concepts; train the students to apply international accounting terminology and methods which are used to prepare international accounting reports of an enterprise.

This course will be taught in two parts. The first part of the module provides an introduction to main principles of accounting, classification of accounting sheets and accounting methods as well as procedures in foreign countries.

The second part of the course includes an overview of the accounting of assets and liabilities of an enterprise as well as determination and calculation of income, costs and earnings of an enterprise in foreign countries. The course discusses the issues concerning the system of financial ratios and legislative regulation of accounting in foreign countries.

On completion of the course the students will be able to:

– highlight the main points of accounting and financial reports of an enterprise in foreign countries;

– determine accounts of the operations;

– use accounting procedures to make management decisions in the activity of an enterprise in foreign countries;

– analyze the ratio of different financial statements in annual reports;

– synthesize some of the recently created knowledge in accounting reports of the enterprise;

– explain how International Financial Reporting Standards have been shaped by real world events;

– evaluate the influence of international organizations on income and earnings of an enterprise;

– measure the profitability of an enterprise's activity in foreign countries;

– conduct independent research on relevant topics within a present time limit;

– express an independent opinion, formulate judgments and knowledge-based conclusions on relevant issues in accounting, including international professional and academic literature.

Unit 1

MAIN PRINCIPLES OF ACCOUNTING IN FOREIGN COUNTRIES

TOPICS FOR DISCUSSION

1. Requirements for analytical information.
2. The purpose and ways of harmonization of financial statements.
3. Activities of the International Accounting Standards Committee (IASC).
4. International accounting principles.

TASKS

1.1. Read the definitions of accounting principles and complete them with these words.

Going Concern Matching Conservatism Objectivity Business Entity Monetary Unit Historical Cost Materiality Accounting Period Consistency Accrual

1. ________________

A business is considered as a separate entity from the owner(s) and should be treated separately. Any personal transactions of its owner should not be recorded in the business accounting book unless the owner's personal transaction involves adding and/or withdrawing resources from the business.

2. ________________

It assumes that an entity will continue to operate indefinitely. In this basis, assets are recorded based on their original cost and not on market value. Assets are assumed to be used for an indefinite period of time and not intended to be sold immediately.

3. ________________

The business financial transactions recorded and reported should be in monetary unit, such as Pound Sterling, US Dollar, Canadian

Dollar, Euro, etc. Thus, any non-financial or non-monetary information that cannot be measured in a monetary unit is not recorded in the accounting books, but instead, a memorandum will be used.

4. ________________

All business resources acquired should be valued and recorded based on the actual cash equivalent or original cost of acquisition, not the prevailing market value or future value. Exception to the rule is when the business is in the process of closure and liquidation.

5. ________________

This principle requires that revenue recorded, in a given accounting period, should have an equivalent expense recorded, in order to show the true profit of the business.

6. ________________

This principle entails a business to complete the whole accounting process of a business over a specific operating time period. It may be monthly, quarterly or annually. For annual accounting period, it may follow a Calendar or Fiscal Year.

7. ________________

This principle states that given two options in the valuation of business transactions, the amount recorded should be the lower rather than the higher value.

8. ________________

This principle ensures consistency in the accounting procedures used by the business entity from one accounting period to the next. It allows fair comparison of financial information between two accounting periods.

9. ________________

Ideally, business transactions that may affect the decision of a user of financial information are considered important or material, thus, must be reported properly. This principle allows errors or violations of accounting valuation involving immaterial and small amount of recorded business transactions.

10. ________________

This principle requires recorded business transactions should have some form of impartial supporting evidence or documentation. Also, it entails that bookkeeping and financial recording should be performed with independence, that's free of bias and prejudice.

11. ________________

This principle requires that revenue should be recorded in the period it is earned, regardless of the time the cash is received. The same is true for expense. Expense should be recognized and recorded at the time it is incurred, regardless of the time that cash is paid.

1.2. Complete the following sentences. Choose the correct words, A, B or C, to fill each gap.

1. Adjusting entries help to achieve the __________ principle.

A) matching; B) revenue recognition; C) cost.

2. The cost principle is often described as the __________ cost principle.

A) matching; B) historical; C) materiality.

3. The concept of __________ allows for the violation of an accounting principle when the amounts are insignificant.

A) matching; B) conservatism; C) materiality.

4. Full __________ of information is achieved through the notes to the financial statements.

A) disclosure; B) closing; C) verification.

5. Communicating the significant accounting policies in the first note to the financial statements is related to the full __________ principle.

A) matching; B) disclosure; C) materiality.

6. Under the ________-basis of accounting, revenues are reported on the income statement in the period in which they are earned.

A) matching; B) accrual; C) materiality.

1.3. Choose the correct option (a, b or c).

1. Because of which principle/guideline will the personal assets of the owner of a company **not** appear on the company's balance sheet?

a) Cost;
b) Economic Entity;
c) Monetary Unit.

2. Which principle/guideline requires a company's balance sheet to report its land at the amount the company paid to acquire the land, even if the land could be sold today at a significantly higher amount?

a) Cost;
b) Economic Entity;
c) Monetary Unit.

3. Which principle/guideline allows a company to ignore the change in the purchasing power of the dollar over time?
a) Cost;
b) Economic Entity;
c) Monetary Unit.

4. Which principle/guideline requires the company's financial statements to have footnotes containing information that is important to users of the financial statements?
a) Conservatism;
b) Economic Entity;
c) Full Disclosure.

5. Which principle/guideline justifies a company violating an accounting principle because the amounts are immaterial?
a) Conservatism;
b) Full Disclosure;
c) Materiality.

6. Which principle/guideline is associated with the assumption that the company will continue on long enough to carry out its objectives and commitments?
a) Economic Entity;
b) Going Concern;
c) Time Period.

7. A very large corporation's financial statements have the dollar amounts rounded to the nearest $1,000. Which accounting principle/guideline justifies not reporting the amounts to the penny?
a) Full Disclosure;
b) Materiality;
c) Monetary Unit.

8. Accountants might recognize losses but not gains in certain situations. For example, the company might write-down the cost of inventory, but will not write-up the cost of inventory. Which principle/guideline is associated with this action?
a) Conservatism;
b) Materiality;
c) Monetary Unit.

9. Which principle/guideline directs a company to show all the expenses related to its revenues of a specified period even if the expenses were not paid in that period?

a) Cost;

b) Matching;

c) Monetary Unit.

10. When the accountant has to choose between two acceptable alternatives, the accountant should select the alternative that will report less profit, less asset amount, or a greater liability amount. Which principle/guideline is this based upon?

a) Conservatism;

b) Cost;

c) Materiality.

QUESTIONS FOR SELF-ASSESSMENT

1. What are «generally accepted accounting principles» (or «GAAP»)?
2. What are International Financial Reporting Standards (IFRS)?
3. What is the cost principle?
4. What is the matching principle?
5. What is the full disclosure principle?
6. What is the Materiality Principle?
7. What is the Revenue Recognition Principle?
8. What is the Conservatism Principle?
9. How do the principles affect financial statements?
10. What is periodicity in accounting?
11. What is a natural business year?
12. What does the cost principle mean for a company's income statement?

TASKS FOR SELF-ASSESSMENT

1.4. Choose the correct option (a, b or c).

1. Public utilities' balance sheets list the plant assets before the current assets. This is acceptable under which accounting principle/ guideline?

a) Conservatism;

b) Cost;

c) Industry Practices.

2. A large company purchases a $250 digital camera and expenses it immediately instead of recording it as an asset and depreciating it over its useful life. This practice may be acceptable because of which principle/guideline?

a) Cost;
b) Matching;
c) Materiality.

3. A corporation pays its annual property tax bill of approximately $12,000 in one payment each December 28. During the year, the corporation's monthly income statements report Property Tax Expense of $1,000. This is an example of which accounting principle/guideline?

a) Conservatism;
b) Matching;
c) Monetary Unit.

4. A company sold merchandise of $8,000 to a customer in December. The company's sales terms require the customer to pay the company in 30 days. The company's income statement reported the sale in December. This is proper under which accounting principle/guideline?

a) Full Disclosure;
b) Monetary Unit;
c) Revenue Recognition.

5. Accrual accounting is based on this principle/guideline.

a) Cost;
b) Full Disclosure;
c) Matching.

6. The creative chief executive of a corporation who is personally responsible for numerous inventions and innovations is not reported as an asset on the corporation's balance sheet. The accounting principle/guideline that prevents the corporation from reporting this person as an asset is:

a) Conservatism;
b) Cost;
c) Going Concerns.

7. An asset with a cost of $120,000 is depreciated over its useful life of 10 years rather than expensing the entire amount when it is purchased. This complies with which principle/guideline?

a) Cost;

b) Full Disclosure;
c) Matching.

8. Near the end of the current year, a company required a customer to pay $200,000 as a deposit for work that is to begin in the following year. At the end of the current year the company reported the $200,000 as a liability on its balance sheet. Which accounting principle/guideline prevented the company from reporting the $200,000 on its income statement for the current year?
a) Going Concern;
b) Materiality;
c) Revenue Recognition.

9. A retailer wishes to report its merchandise inventory on its balance sheet at its retail value. This would violate which accounting principle/guideline?
a) Cost;
b) Full Disclosure;
c) Monetary Unit.

10. A company borrowed $100,000 in December and will make its only payment for interest when the note comes due six months later. The total interest for the six months will be $3,600. On the December income statement the accountant reported Interest Expense of $600. This action was the result of which accounting principle/guideline?
a) Cost;
b) Matching;
c) Revenue Recognition.

Unit 2

PROCEDURES OF DRAWING UP A BALANCE SHEET AND FINANCIAL REPORTS IN FOREIGN COUNTRIES

TOPICS FOR DISCUSSION

1. Structure and elements of financial statements.
2. Balance Sheet.
3. Statement of Cash Flows.
4. Statement of Changes in Equity.
5. Income Statement.
6. Earnings Per Share.

TASKS

2.1. Match each object (1-4) with two of its components (a-d).

Term	Explanation
1. INCOME STATEMENT	a. presents assets, liabilities and owners' equity on a specific date. It is also called a Statement of Financial Position
2. STATEMENT OF CHANGES IN EQUITY	b. summarizes information about cash outflows (payments) and inflows (receipts). This statement may also include certain information not related to actual cash flows
3. BALANCE SHEET	c. presents revenues and expenses and resulting net income or net loss for a period of time. This statement is also called a Statement of Operations, an Earnings Statement, or a Profit and Loss Statement (P/L)
4. STATEMENT OF CASH FLOWS	d. shows all changes in owners' equity for a period of time. This statement is also called an Owners' Equity Statement

2.2. Read the definitions of elements of financial statements and complete them with these words and word combinations.

Liabilities Revenue Equity Losses Assets Expenses Gains Contributed Capital Net Income

1. ________________ are the economic resources a business uses to accomplish its main goal (i.e., increase the owners' wealth). There are three characteristics: future probable economic benefit; controlled by the entity; and result from prior events or transactions.
2. ________________ are debts and obligations of an entity, can be short-term (current) or long-term (non-current).
3. ________________ (also called net worth or net assets) is what an entity «owes» to owners, can be called shareholders' equity in a corporation or owner's equity in a sole proprietorship.
4. ________________ (also called paid-in capital) is a component of shareholders' equity resulting from contributions of capital resources from owners.
5. ________________ is an increase in assets (e.g., cash sale) or decrease in liabilities (e.g., recognition of unearned service revenue as earned revenue) resulting from operating activities of an entity.
6. ________________ are decreases in assets or increases in liabilities that result from operating activities undertaken to generate revenue.
7. ________________ is the excess of revenues over expenses for an accounting period.
8. ________________ are similar to revenues; however, gains result from incidental transactions rather than from operating activities.
9. ________________ are similar to expenses in the way that both decrease assets or increase liabilities; however, losses differ from expenses in that they are caused by incidental transactions, rather than from ordinary operating.

2.3. Read the definitions of asset accounts and complete them with these words and word combinations.

Petty Cash Accounts Receivable Temporary Investments Supplies Cash Prepaid Insurance

1. _________________

A current asset account which includes currency, coins, checking accounts, and undeposited checks received from customers. The amounts must be unrestricted.

2. _________________

A current asset account that represents an amount of cash for making small disbursements for postage due, supplies, etc.

3. _________________

A current asset account which contains the amount of investments that can and will be sold in the near future.

4. _________________

A current asset resulting from selling goods or services on credit (on account). Invoice terms such as (a) net 30 days or (b) 2/10, n/30 signify that a sale was made on account and was not a cash sale.

5. _________________

A current asset representing the cost of supplies on hand at a point in time.

6. _________________

A current asset which indicates the cost of the insurance contract (premiums) that have been paid in advance. It represents the amount that has been paid but has not yet expired as of the balance sheet date.

2.4. Choose the correct option (a, b, c or d).

1. Another name for the balance sheet is

a) Statement of Operations;
b) Statement of Financial Position.

2. The balance sheet heading will specify a

a) Period of Time;
b) Point in Time.

3. Which of the following is a category or element of the balance sheet?

a) Expenses;
b) Gains;
c) Liabilities
d) Losses.

4. Which of the following is an asset account?

a) Accounts Payable;
b) Prepaid Insurance;
c) Unearned Revenue.

5. Which of the following is a contra account?
a) Accumulated Depreciation;
b) Mary Smith, Capital.

6. What is the normal balance for an asset account?
a) Debit;
b) Credit.

7. What is the normal balance for liability accounts?
a) Debit;
b) Credit.

8. What is the normal balance for stockholders' equity and owner's equity accounts?
a) Debit;
b) Credit.

9. What is the normal balance for contra asset accounts?
a) Debit;
b) Credit.

10. Client Jay pays ABC Co. $1,000 in December for ABC to perform services for Jay in 45 days. ABC uses the accrual basis of accounting. In December ABC will debit cash for $1,000. What will be the other account involved in the December accounting entry prepared by ABC (and what type of account is it)?
a) Accounts Receivable (asset);
b) Prepaid Services (asset);
c) Service Revenues (revenue);
d) Unearned Revenues (liability).

2.5. An owner contributed $5,000 cash into the business. Which of the following correctly represents the cash contribution transaction?

a)

		Claims		
Assets	=	**Liabilities**	+	**Equity**
+$10,000	=	+$10,000	+	

b)

		Claims		
Assets	=	**Liabilities**	+	**Equity**
+$5,000	=	+$5,000	+	+$5,000

c)

		Claims		
Assets	=	**Liabilities**	+	**Equity**
+$5,000	=		+	+$5,000

Solution

The correctly represented cash contribution transaction: Option **c).**

!!! *Note that the amount of this single transaction is recorded twice. The first time it is recorded as an asset and the second time it is recorded as equity (the asset source). In accounting any transaction is recorded at least twice, as a rule. This rule is known as double-entry bookkeeping.*

2.6. Complete the following sentences. Choose the correct word or word combination.

Outstanding ***Ownership*** ***Preferred***
Articles of Incorporation ***Stockholders' Equity***
Common (× 2) ***Par Value***

1. To start a corporation in the U.S., it is necessary to file an application in one of the states. The legal document that the state approves is the ___________.
2. One of the advantages of the corporation form of business as opposed to a partnership form is the ease of transferring ___________.
3. At a corporation, Assets minus Liabilities is ___________.
4. Shares of stock that have been issued and have not been reacquired by the issuing corporation are called ___________shares.
5. If a corporation has issued only one type of stock, it is ___________stock.
6. The type of stock that gets its dividend before the common stock gets its dividend is called ___________stock.
7. The holders of ___________stock elect the corporation's board of directors.
8. The par value of ___________stock usually has no economic significance.
9. The dividend on preferred stock is often expressed as a percentage. To calculate the annual dividend on preferred stock, you multiply the percentage times the ___________ of the preferred stock.

2.7. The Earnings Per Share Calculation.

!!! ***Earnings per share*** *are not part of stockholders' equity. Nonetheless, we are including an introduction to the topic here because the calculation of earnings per share involves the stock of a corporation. Earnings per share must appear on the face of the income statement if the corporation's stock is publicly traded. The earnings per share calculation is the after-tax net income (earnings) available for the common stockholders divided by the weighted-average number of common shares outstanding during that period.*

I. Earnings Available for Common Stock

Let's assume that a corporation has the following stockholders' equity as of December 31:

Stockholders' Equity

Paid-in capital		
9% Preferred stock, $100 par, 300 shares authorized and issued	$	30,000
Common stock, $0.10 par, 10,000 shares authorized, 2,000 shares issued and outstanding		200
Paid-in capital in excess of par-common		49,800
Total paid-in capital		80,000
Retained earnings		28,000
Total stockholders' equity	$	108,000

Additional information:

1. The corporation's accounting year is the calendar year.
2. The corporation's net income after taxes is $10,000.
3. The number of shares of common stock outstanding was 600 shares for the first four months of the year. On May 1 the corporation issued additional 900 shares. On October 1 it issued additional 500 shares.
4. The shares of preferred stock were outstanding for the entire year.

The earnings (net income after income taxes) available for the common stockholders is:

Corporation's net income after income taxes	$	10,000
Less: Preferred dividend requirement*		- 2,700
Earnings available for common stock	$	7,300

*The preferred dividend requirement is the annual dividend of $9 per share (9% multiplied by $100 par value) multiplied by 300 shares of preferred stock outstanding.

II. Weighted-Average Number of Shares of Common Stock

Since the earnings occurred throughout the entire year, we need to divide them by the number of shares that were outstanding throughout the entire year. During the first four months only 600 shares were outstanding, during the next five months 1,500 shares were outstanding, and for the final three months of the year 2,000 shares of common stock were outstanding. This situation requires that we come up with an average number of shares of common stock for the year.

Shares of Common Outstanding	Months Outstanding	No. of Month Divided by 12	Weighted Average No. of Common Shares
600	Jan, Feb, Mar, Apr	4/12	200
1,500	May, Jun, Jul, Aug, Sept	5/12	625
2,000	Oct, Nov, Dec	3/12	500
			1,325

As the calculation shows, the weighted-average number of shares of common stock for the year was 1,325.

It's a good idea to test this answer to be sure it's reasonable. During five of the months (May – Sep.) the number of shares of common stock outstanding was 1,500 shares. During the remainder of the year, there were more months with less than 1,500 shares outstanding. Thus, the figure of 1,325 looks reasonable.

III. Earnings per Share of Common Stock

After recognizing the preferred stockholders' required dividend, there was $7,300 ($10,000 minus $2,700) of **earnings available for the common stockholders**. The $7,300 was earned throughout the year, so we need to divide that amount by the weighted-average number of shares of common stock outstanding throughout the year:

The **earnings per share** (EPS) of common stock = earnings available for common stock *divided* by the weighted-average number of common shares outstanding:

$$EPS = \frac{\$7{,}300}{1{,}325}.$$

EPS = **$5.51** per share of common stock.

QUESTIONS FOR SELF-ASSESSMENT

1. What are the elements of financial statements?
2. What is an account payable?
3. What is a creditor?
4. What is the statement of financial position?
5. What is a current asset?
6. What is a current liability?
7. What is an owner's equity?
8. What is turnover?
9. What is the purpose of the cash flow statement?
10. What are some examples of financing activities?
11. What is capital stock?
12. What is a dividend and why is it needed?
13. What is the difference between net cash flow and net income?
14. What is the difference between the Cash Flow and Funds Flow statements?
15. Are earnings different from profits?
16. Which financial statement shows a corporation's worth?
17. What is the difference between stocks and bonds?
18. What is the difference between liability and debt?

TASKS FOR SELF-ASSESSMENT

2.8. There are four parts of the Statement of Cash Flows (or Cash Flow Statement): ***Operating*** *Activities,* ***Investing*** *Activities,* ***Financing*** *Activities,* ***Supplemental*** *Activities****.*** *For each of the following items, indicate which part will be affected. Choose the correct option (a, b or c).*

1. Depreciation Expense.
a) Operating; b) Investing; c) Financing; d) Supplemental.

2. Proceeds from the sale of equipment used in the business.
a) Operating; b) Investing; c) Financing; d) Supplemental.

4. Declaration and payment of dividends on company's stock.
a) Operating; b) Investing; c) Financing; d) Supplemental.

5. Gain on the Sale of Automobile formerly used in the business.
a) Operating; b) Investing; c) Financing; d) Supplemental.

2.9. For a recent year a corporation's financial statements reported the following:

Net income	$	100,000
Depreciation expense		10,000
Increase in accounts receivable		30,000
Decrease in accounts payable		15,000

Based on the above information, what amount will the corporation report as Cash Provided by Operating Activities on the cash flow statement?

a) $65,000;
b) $125,000;
c) $155,000.

2.10. A corporation reported the following information for the past year:

Net income	$	200,000
Depreciation expense		30,000
Gain on sale of truck		5,000
Proceeds from sale of truck		8,000
Decrease in accounts receivable		10,000

Assuming these are the only facts, what amount will the corporation report as the Cash Provided by Operating Activities on the cash flow statement?

a) $225,000;
b) $235,000;
c) $253,000.

Unit 3
CLASSIFICATION OF ACCOUNTING SHEETS IN FOREIGN COUNTRIES

TOPICS FOR DISCUSSION

1. Accounting documents as accounting information carriers and their classification.
2. Requirements for content and preparation of the documents.
3. The role of accounting documents, their importance in operational activities, financial control and audit.

3.1. Read and decide if the following statements (1-5) are true or false.

1. The source document is the initial input to the accounting process and serves as objective evidence of the transaction.

a) True; b) False.

2. A well-designed source document form can minimize errors and improve the efficiency of transaction recording.

a) True; b) False.

3. The source document can be created only in paper format.

a) True; b) False.

4. The source document provides the information required to analyze and classify the transaction and to create the journal entries.

a) True; b) False.

5. The source document doesn't describe the basic facts of the transaction such as its date, purpose, and amount.

a) True; b) False.

3.2. From the following particulars fill in source documents and prepare a Petty Cash Book under Imprest System (Jan., 2013):

Company name: *Company «Alfa»*

Jan. 1. Received $400 as imprest cash from the Chief Cashier.

Jan. 3. Paid postage $28.

Jan. 4. Purchased stationery $48:

– 10 pencils @ $10;

– staples stationery/1 pack @ $8).
Jan. 7. Paid $72 for repairs of a computer (2 hours).

PETTY CASH VOUCHER

DATE	ITEM	AMOUNT	
	TOTAL		

AUTHORIZED BY ____________ RECEIVED BY ____________

www.PrintableCashReceipts.com

PETTY CASH VOUCHER

DATE	ITEM	AMOUNT	
	TOTAL		

AUTHORIZED BY ____________ RECEIVED BY ____________

www.PrintableCashReceipts.com

PETTY CASH VOUCHER

DATE	ITEM	AMOUNT	
	TOTAL		

AUTHORIZED BY ____________ RECEIVED BY ____________

www.PrintableCashReceipts.com

Petty Cash Receipt

Petty Cash Receipt Template

Date_______________________ **No.** _________

	Amount $_______________
Description	
Charged to	
Received by	
Approved	

!!! *A* ***petty cash voucher*** *is usually a small form that is used to document a disbursement (payment) from a petty cash fund. Petty cash vouchers are also referred to as* ***petty cash receipts*** *and can be purchased from office supply stores.*

PRINTABLE CASH RECEIPT
(*Jan. 3, 2013, No 456-2, «Express Delivery»*)

RECEIPT

Number ____________

Date ____________

Received from ______________________________ $ ____________

Dollars

For ______________________________

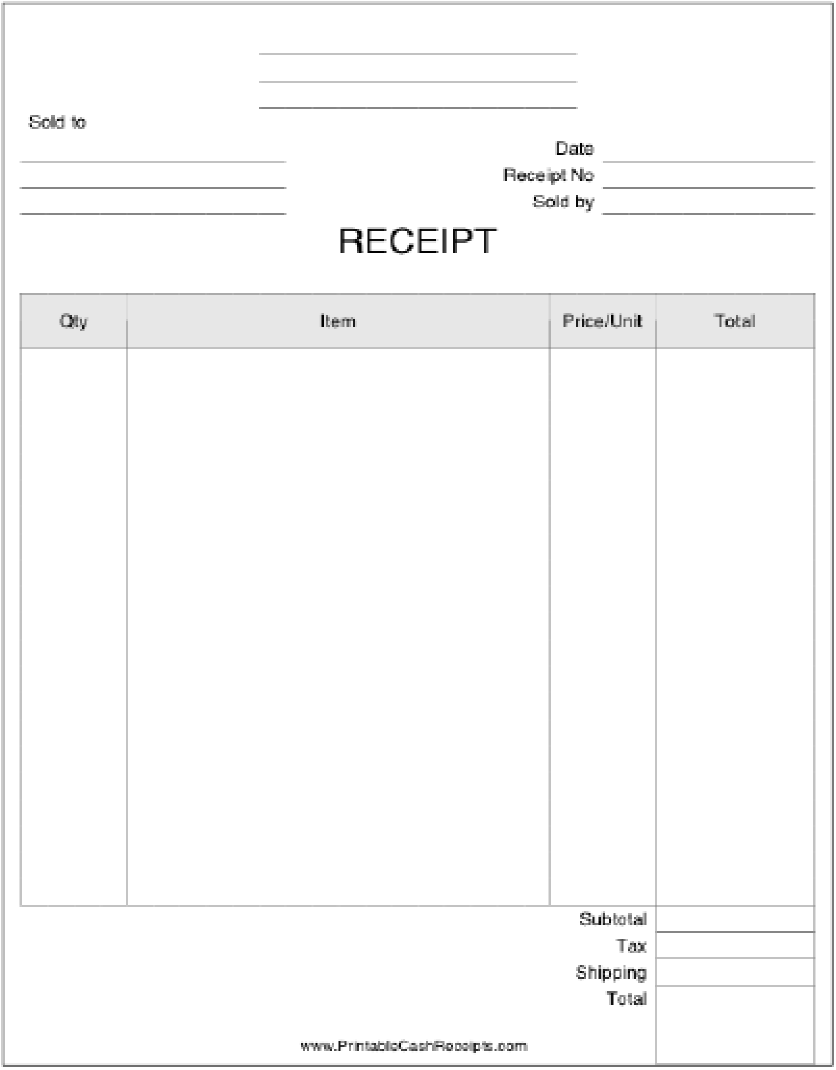
Amount of account	☐	☐	Cash
This payment	☐	☐	Check
Balance due	☐	☐	Money Order

By ____________

www.PrintableCashReceipts.com

!!! *Three identical cash receipts are on one page, formatted horizontally with the word "receipt" at the far left as in a payment book. It includes spaces to record installment payments and how they are paid.*

BUSINESS RECEIPT (*Jan. 4, 2013, No 132/1, XYZ-Company*)



Sold to

Date
Receipt No
Sold by

RECEIPT

Qty	Item	Price/Unit	Total

Subtotal
Tax
Shipping
Total

www.PrintableCashReceipts.com

!!! *A business receipt has a generous blank area for recording quantity, item descriptions, and other details of a purchase.*

RECEIPT FOR SERVICES *(Jan. 7, 2013)*

RECEIPT
FOR SERVICES

______________________ Date ____________

____

____

Item	Hours	Rate	Total
		TOTAL	

www.PrintableCashReceipts.com

!!! *This simple receipt can be used by a business, freelancer, laborer, or anyone who bills by the hour for services rendered.*

PETTY CASH SHEET

!!! ***Petty cash sheet*** *principally helps you to maintain small cash which usually becomes the victim of ignorance. With the help of a petty cash template, you can divide your cash into two categories that is small and big one. All transactions which belong to petty cash can be recorded on this template and can be balanced multiple times a day.*

____
Company Name

Address: ________________
Website: ________________
Email ___________________
Phone: __________________
Fax: ____________________

Company Logo Here
Company Logo

Petty Cash Sheet

Department Name: ______________________
Prepared BY: ___________________________

Date	Particulars	Cash In ($)	Cash Out ($)
	Total		

____
Authorized Signatures

PETTY CASH BOOK

!!! *It is another Cash Book which is maintained, generally, in large business concerns to reduce the burden of 'Main Cash Book', in which numerous transactions involving petty (small) amounts are recorded. For this purpose, a Petty Cashier is appointed by the Chief Cashier. The Chief Cashier advances a sum of money to the Petty Cashier to enable him to meet petty expenses for a fixed period. The Petty Cashier will record this amount on the Debit Side of the Petty Cash Book while the Chief Cashier will record the same amount on the Credit Side of the Main Cash Book.*

Amount Received $	Date	Particu-lars	V. No	Total $	Traveling Expenses $	Postages $	Statio-nery $	Office Expenses $	Misc. Expenses $
		Balance c/d							
		Balance b/d							
		Cash received							

!!! ***Balance c/d*** *= carried down = the closing balance, also known as carry forward.*

Balance b/d *= brought down = the opening balance, also known as brought forward.*

QUESTIONS FOR SELF-ASSESSMENT

1. What is a source document?
2. What is Cash Book?
3. What is Petty Cash Book?
4. What are General Forms?
5. What is a Template?
6. What is an Invoice?
7. What is a Purchase Order?
8. What is a Receiving Record?

TASKS FOR SELF-ASSESSMENT

3.3. From the following particulars prepare a Petty Cash Book under Imprest System (Jan., 2013):

Jan. 1. Received $200 as imprest cash from the Chief Cashier.
Jan. 2. Paid $20 for a taxi.
Jan. 3. Paid $20 for stationery.
Jan. 4. Purchased stationery for $20.
Jan. 5. Paid telegram charges $30 and bus fare $5.
Jan. 6. Bought postage stamps for $15.
Jan. 7. Paid $70 for repairs of a computer.

Amount Received $	Date	Particulars	V. No	Total $	Traveling Expenses $	Postages $	Stationery $	Office Expenses $	Misc. Expenses $
		Balance c/d							
		Balance b/d							
		Cash received							

Unit 4
ACCOUNTING METHODS AND PROCEDURES IN FOREIGN COUNTRIES

TOPICS FOR DISCUSSION

1. Accounting Cycle.
2. Special Journals.
3. The General Ledger.
4. Records in the Accounting Journals.

TASKS

4.1. Complete the following sentences. Choose the correct words, A or B, to fill each gap.

1. A ___________ amount will appear on the left side of a T-account.
A) Debit; B) Credit.

2. When a check is written, a cash account should be ___________.
A) Debit; B) Credit.

3. Liability accounts will normally have ___________ balances.
A) Debit; B) Credit.

4. Revenue accounts will normally have ___________ balances.
A) Debit; B) Credit.

5. Large corporations should report revenues on their income statements when the ___________.
A) Cash is Received; B) Revenues Are Earned.

6. Accrued expenses are likely to pertain to transactions that have ___________ been paid.
A) Already; B) Not Yet.

7. Deferred revenues likely involve cash amounts that have ___________ been received.
A) Already; B) Not Yet.

8. The book of original entry is the definition of a ___________.
A) Journal; B) Ledger.

4.2. Complete the following sentences. Choose the correct word or word combination.

Accrual	***Double***	***Equity***	***Receivable reversing***
Chart	***Trial***	***Liability***	
Controls	***Reconciliation***	***Current***	

1. The two main methods of bookkeeping and accounting are 1) the cash method, and 2) the ___________ method.
2. ___________ -entry bookkeeping means that every transaction will affect two or more accounts.
3. A listing of the balances in the accounts in order to determine whether debits are equal to credits is a ___________balance.
4. The listing of accounts that are available for posting transactions is the ___________of accounts.
5. The bookkeeping or accounting equation is Assets = Liabilities + Owner's ___________.
6. When a sale is made on credit, the seller will debit the asset account Accounts ___________.
7. Asset, ___________, and stockholders' equity accounts are known as balance sheet accounts.
8. The difference between the balance in a company's cash account and its bank statement is documented in the ___________of the bank statement.
9. A _____________entry typically removes an accrual-type adjusting entry that had been recorded in the preceding accounting period.
10. Cash and Accounts Receivable are two examples of accounts that are reported on the classified balance sheet under the heading ___________assets.
11. The separation of duties is part of the internal ___________ for safeguarding assets.

4.3. Complete the following sentences. Choose the correct word combination.

sales journal (× 2)	***cash book***	***purchases returns***
purchase journal (× 2)	***proper journal***	***sales returns***

1. Credit purchases of goods are recorded in ________________.
2. Credit sales of goods are recorded in ________________.
3. Credit purchases of machinery are to be recorded in __________.
4. Cash purchases of furniture and fixture are to be recorded in ________.
5. Credit note is the basis of recording ___________ book (journal).
6. Debit note is the basis of recording ___________ book (journal).
7. Invoice is the basis for recording _____________ book (journal).
8. Outward invoice is the basis for recording _______ book (journal).

4.4. Records in the Accounting Journals.

PURCHASES JOURNAL

Example:

Enter the following transactions into the purchase journal:

1. Jan. 10, 2013, purchased 400 kg of sugar from S & sons. @ $10 per kg on credit.
2. Jan. 15, 2013, purchased 200 liters of mustard oil from R & Co. @ $12 per liter.
3. Jan. 23, 2013, purchased 100 kg of soap from Lever Bros. @ $10 per kg.

Purchase Journal (Book)

Date	Description	Invoice No.	L/F	Details $	Amount $
10.1.2013	**S & sons.** 400 kg of sugar @ $10/kg	--	CL-8	4000	4000
15.1.2013	**R & Co.** 200 liters mustard oil @ $12/liter	--	CL-10	2400	2400
23.1.2013	**Lever Bros.** 100 kg of soap @ $10/kg	--	CL-14	1000	1000
31.1.2013	Purchases account Dr.		GL-16		7400

SALES JOURNAL

Example:

Enter the following transactions into the sales journal:

1. June 4, 2013, sold on credit to O:
10 tables @ $150
30 chairs @ $100
2. June 11, 2013, sold on credit to S:
1 dining table @ $1,500
3. June 30, 2013, sold on credit to T restaurant:
100 chairs @ $150
20 tables @ $200
4. The trader offers a trade discount at the following rates:
Sales up to $2,000 – 5%
Sales over $2,000 – 10%

Sales Journal (Book)

Date	Description	Invoice No.	L/F	Details $	Amount $
4.6.2013	**O.** 10 tables @ $150 30 chairs @ $100 Less a 10% trade discount	135	DL- 15	 1500 3000 --------- 4500 450 ---------	 4050
11.6.2013	**S.** 1 dining table @ $1500 Less a 5% trade discount	136	DL- 17	 1500 75 ---------	 1425
30.6.2013	**T restaurant.** 100 chairs @ $150 20 tables @ $200 Less a 10% trade discount	137	DL- 19	 15000 4000 --------- 19000 1900 ---------	 17100
30.6.2013	Sales account Cr.		GL- 30		22575

PURCHASES RETURNS OR RETURNS OUTWARDS JOURNAL

Example:

Enter the following transactions in the purchases returns journal and post them to the ledger accounts:

– Jan.5, 2013, returned to Sunshine Biscuit Co.:

10 cases of biscuits @ $125 per case for damage in transit;

– Jan. 18, 2013, returned to S Stores:

3 bags of sugar @ $500 per bag since it was not according to the order;

– Jan. 26, 2013, returned to P Flour Mills:

10 bags of flour @ $200 per bag since it was not according to specification, less a discount of 5%.

Solution:

Purchases Returns Journal (Book)

Date	Description	Debit Note No.	L/F	Details $	Amount $
5.1.2013	Sunshine Biscuit Co. 10 cases of biscuits @ $125 per case (Being damaged in transit)	-----	CL. 8	1250	1250
18.1.2013	S Stores 3 bags of sugar @ $500 per bag (Not according to the order)	-----	CL. 12	1500	1500
26.1.2013	P Flour Mills 10 bags of flour @ $200 per bag Less discount 5% (Not according to specification)	-----	CL. 16	2000 100 -------	1900
31.1.2013	Purchases returns A/C Cr.			GL. 18	4650

SALES RETURNS OR RETURNS INWARDS JOURNAL

Example:

Enter the following transactions in the sales returns or returns inwards journal and post them to the ledger accounts:

– Feb. 3, 2013, received back from Q Bros.:

5 bundles of shirts @ $2,000 per bundle for inferior quality. Less a trade discount of 10%;

– Feb. 10, 2013, Mr. A returned 10 bales of cloth @ $2,500 per bale since it was not according to order;

– Feb. 27, 2013, Returned by M. R 25 pairs of stock @ \$20 per pair for wrong size. Less a discount of 10%.

Solution:

Sales Returns Journal (Book)

Date	Description	Debit Note No.	L/F	Details \$	Amount \$
3.2.2013	Q Bros. 5 bundles of shirts @ \$2,000 per bundle Less a trade discount of 10% (Goods being of inferior quality)	-----	CL.15	10,000 1000 ----------	9000
10.2.2013	Mr. A 10 bales of cloth @ \$2,500 per bale: (Not according to the order)	-----	CL. 19	25000	25000
27.2.2013	M. R 25 pairs of socks @ \$20/pair Less a discount of 10% (Being goods not according to size)	-----	DL. 25	500 50 -------	450
29.2.2013	Sales returns A/C Cr.		GL. 30		34450

THE GENERAL LEDGER

Example:

Enter the following transactions in the journal and post them into the ledger:

2013	
Jan. 1	Mr. Javed started business with cash \$100,000
2	He purchased furniture for \$20,000
3	He purchased goods for \$60,000
5	He sold goods for cash \$80,000
6	He paid salaries \$10,000

Solution:

Journal

Date	Particular	L.F	Amount	Amount
2013				
Jan. 1	Cash A/C ....Dr. Capital (Being capital brought in)	9 11	100,000	100,000
1	2	3	4	5
2	Furniture A/C..................................Dr. Cash A/C (Being furniture purchased for cash)	13 9	20,000	20,000
3	Purchases A/C.................................Dr. Cash A/C (Goods purchased for cash)	15 9	60,000	60,000
5	Cash A/C...Dr. Sales A/C (Sold goods for cash)	9 17	80,000	80,000
6	Salaries A/C.....................................Dr. Cash A/C Return (Salaries paid)	19 9	10,000	10,000

The general ledger

Cash Account

Date	Particular	J.R	Amount	Date	Particulars	J.R	Amount
2013				2013			
Jan.1	Capital A/C	1	100,000	Jan.2	Furniture A/C	1	20,000
Jan.5	Sales A/C	1	80,000	Jan.3	Purchases A/C	1	60,000
				Jan.6	Salaries A/C	1	10,000
					Balance c/d		*90,000*
	Total		**180,000**		**Total**		**180,000**

Capital Account

Date	Particular	J.R	Amount	Date	Particulars	J.R	Amount
2013				2013			
Jan.6	*Balance c/d*		*100,000*	Jan.1	Cash A/C	1	100,000
	Total		**100,000**		**Total**		**100,000**

Furniture Account

Date	Particular	J.R	Amount	Date	Particulars	J.R	Amount
2013				2013			
Jan.2	Cash A/C	1	20,000	Jan.6	*Balance c/d*		*20,000*
	Total		**20,000**		**Total**		**20,000**

Purchases Account

Date	Particular	J.R	Amount	Date	Particulars	J.R	Amount
2013				2013			
Jan.3	Cash A/C	1	60,000	Jan.6	*Balance c/d*		*60,000*
	Total		**60,000**		**Total**		**60,000**

Sales Account

Date	Particular	J.R	Amount	Date	Particulars	J.R	Amount
2013				2013			
Jan.6	*Balance c/d*		*80,000*	Jan.5	Cash A/C	1	80,000
	Total		**80,000**		**Total**		**80,000**

Salaries Account

Date	Particular	J.R	Amount	Date	Particulars	J.R	Amount
2013				2013			
Jan.6	*Cash A/C*	1	*10,000*	Jan.6	*Balance c/d*		10,000
	Total		**10,000**		**Total**		**10,000**

QUESTIONS FOR SELF-ASSESSMENT

1. What is a journal?
2. What is a general Journal?
3. What is a recurring journal entry?
4. What is a monthly close?
5. What is a purchases book or purchases journal?
6. What is a sales book or sales journal?
7. What is a purchases returns book or purchases returns journal?
8. What is a sales returns book or sales returns journal?
9. What is a sales returns book or sales returns journal?
10. What is a bills receivable book?

11. What is a bills payable book?
12. What is a cash book or cash journal?
13. What is a petty cash book?
14. What is an account?
15. What are closing entries?
16. What is an account?
17. What are adjusting entries?

TASKS FOR SELF-ASSESSMENT

4.5. Fill in the form with the given information:

You are a bookkeeper for Q Bros. A customer has just shopped in your store on 9/16/2013 and purchased the following items:

– 3 pairs of socks for a total of $12.00;
– 2 men's shirts for a total of $55.00.

This makes the total sale $67.00. The sales tax in your state is 6% for a total of $4.02 in sales tax. The sales total is $71.02. The customer plans to buy these items for cash. Here is the bookkeeping entry you would make, hopefully using your computer accounting software, to record the journal transaction.

Here is how the entry would look:

Sales Journal Entry – Cash Receipts for 9/16/2013

	Debit	Credit
Cash in Checking $		
Sales		
Sales Tax Collected		

4.6. Fill in the form with the given information:

You are a bookkeeper for Q Bros. Your store is having a sale and everything is 10% off. A customer has just shopped in your store on 9/16/2013 and purchased the following items:

– 3 pairs of socks for a total of $12.00;
– 2 men's shirts for a total of $55.00.

This makes the sub-total sale $67.00, not including the discount. The sales tax in your state is 6% for a total of $4.02 in sales tax and a $6.70 discount. The sales total is $71.02. Here is the bookkeeping entry you would make, hopefully using your computer accounting software, to record the journal transaction.

Here is how the entry would look:

Sales Journal Entry – Discount Sale – 9/16/13

	Debit	Credit
Cash in Checking $		
Sales Discount		
Sales		
Sales Tax Collected		

Unit 5
ACCOUNTING OF ASSETS AND LIABILITIES OF BUSINESSES IN FOREIGN COUNTRIES

TOPICS FOR DISCUSSION

1. Accounting for Inventory.
2. The inventory cost flow methods:
   a. First in First Out (FIFO).
   b. Last in First Out (LIFO).
   c. Average Cost Method (AVCO).
3. The methods of depreciation of fixed assets:
   a. Straight Line Method of Depreciation.
   b. Sum of the Years' Digits Method of Depreciation.
   c. Reducing Balance Method of Depreciation.
   d. Units of Production Depreciation Method.
4. Disposal of Fixed Assets.
5. Account of Liabilities.

TASKS

5.1. Which of the following are examples of fixed assets?

1. Cars on display at a showroom.
2. Machine installed at a factory.
3. Employees with more than one year of service remaining before their retirement.

5.2. An asset is purchased on 1st July 2013 for $90,000. The asset has 3 years of useful life at the end of which it is not expected to have any salvage value. How much depreciation expense should be charged in the accounting year ending on 31st December 2014 according to the sum of the years' digits method?

1. $22,500;

2. $15,000;
3. $37,500;
4. $30,000;
5. $45,000.

5.3. «Alfa» Company, a construction company, purchases raw materials for use in its ongoing projects. Which of the following may be included in the cost of inventory?

1. Non-refundable import tariff.
2. Construction costs incurred in building shed for safe storage of inventory at construction sites.
3. Warehousing costs for storage of inventory.
4. Transportation charges paid for the delivery of inventory at the company's warehouse.
5. Sales tax on purchase of inventory.

5.4. Which of the following is true regarding Straight Line Depreciation?

1. It prevents bias in situations when the pattern of economic benefits from an asset is hard to estimate.
2. Once straight line depreciation charge is determined, it is not revised subsequently.

5.5. Which of the following is true regarding Reducing Balance Method of depreciation?

1. It results in higher reported profits in the early years of an asset's life.
2. It is a more suitable method for depreciating assets that generate higher economic benefits later in their useful life.
3. It must be applied where an asset is expected to face technological obsolescence relatively quickly.

5.6. «Alfa» Company sells leather jackets. Due to the seasonal nature of the business, «Alfa» Company sells its merchandise as soon as possible to avoid the risk of downward fluctuation in prices towards the end of the winter season. Which of the following methods is the most suitable for the valuation of «Alfa» Company's inventories?

1. LIFO Method.
2. FIFO Method.
3. Average Cost Method.
4. Actual Unit Cost Method.

5.7. Illustration of the inventory cost flow methods.

Example of FIFO cost flow method

When a sale takes place, two entries are usually made in accounting books. One is for revenue recognition and the other one is for expense (cost of sales or cost of goods sold) recognition. In our example, the revenue recognition entry has the same sales amount regardless of the cost flow method which is $10,800 for 270 goods. The revenue recognition increases both assets (Cash) and equity (by increasing Sales Revenue). This is as asset source transaction.

The cost of goods sold will be different under different cost flow methods. Under FIFO, the cost of goods sold is determined by adding up the costs of 270 goods acquired first. The cost of the first 270 units available on hand is calculated as follows:

Cost of goods sold under FIFO

Beginning Inventory	100 units x $15	=	$1,500
Purchase One	120 units x $18	=	$2,160
Purchase Two	50 units x $20	=	$1,000
Total	270 units		$4,660

The recognition of cost of goods sold decreases assets (Inventory) and equity (by increasing Cost of Goods Sold). The 30 units from the second purchase remain in the Inventory account.

The gross margin and net income equal $6,140 ($10,800 – $4,660). The gross margin and net income are the same in this simplified case because there are no other expenses besides the cost of goods sold. To determine the income tax expense, we need to multiple the net income by the income tax rate. The rate is 30%, so the income tax is $1,842 ($6,140 x 30%). The effect of the income tax payment is a decrease in assets (Cash) and equity (by increasing Income Tax Expenses).

Example of LIFO cost flow method

Under LIFO, the cost of goods sold is calculated by using the costs of goods purchased last. The computation is shown below.

Cost of goods sold under LIFO

Purchase Two	80 units x $20	=	$1,600
Purchase One	120 units x $18	=	$2,160
Beginning Inventory	70 units x $15	=	$1,050
Total	270 units		$4,810

The 30 units from the beginning inventory remain in the Inventory account. The net income is determined by subtracting the cost of goods sold from sales: \$5,990 (\$10,800 − \$4,810). The income tax to be paid is \$1,797 (\$5,990 × 30%).

Example of average cost method

Under this method, the average cost per unit needs to be calculated first. This is done by dividing the cost of goods available for sale by the number of units available for sale.

Data for calculating average cost

<u>The cost of goods available for sale:</u> 100 × \$15 + 120 v \$18 + 80 × \$20 = \$5,260 <u>The number of goods available for sale:</u> 100 + 120 + 80 = 300 units

Based on the above information, the average cost per unit is \$17.53, rounded to a cent: \$5,260 × 300 units.

Next, to determine the cost of goods sold the number of goods sold is multiplied by the average cost. In our example, the cost of goods sold is \$4,733.1 (\$17.53 × 270 units). The net income is \$6,066.9 (\$10,800 − \$4,733.1) and the income tax is \$1,820.07 (\$6,066.9 × 30%).

5.8. Illustration of the methods of depreciation of fixed assets.

Straight Line Method of Depreciation:

!!! ***Straight line method*** *is also known as fixed installment method and original cost method. This method is very simple and conceptually appropriate to employ. This is one of the most widely used methods for the calculation of depreciation charge. By this method, the number of years of use is estimated and the cost is then divided by the number of years to give the depreciation charge each year. Under this method the amount of depreciation will be equal each year, since depreciation is charged at fixed rate on cost of asset. This is the special feature of this method.*

Formula:

Depreciation charge under this method is calculated by using the following formula:

$$\frac{\text{Cost less salvage value}}{\text{Estimated service life}} = \text{Depreciation charge}$$

Example:

Assume a machine was bought for $500,000 and we thought we would keep it for four years and then sell it for $50,000 (salvage value), the depreciation to be charged each year would be calculated as follows:

$$\frac{\text{Cost less salvage value}}{\text{Estimated service life}} = \text{Depreciation charge}$$

$$\frac{500{,}000 - \$50{,}000^{*}}{5} = \$90{,}000$$

*Salvage value

Advantages:

1. Straight line method or fixed installment method is very easy to employ because of its simplicity.
2. The asset can be written off to zero value under this method.
3. This method is useful for providing depreciation on leasehold property, patent right, trade mark, copyright etc.

Disadvantages:

There are two major objections to the straight line method. These are:

1. This method assumes the same economic usefulness of the asset each year.
2. The repair and maintenance expenses are essentially same each period.

Another problem in the use of straight line method or fixed installment method of depreciation is that its use results in distortion in the rate of return analysis (income/assets). The following example shows how the rate of return increases, given constant revenue flows, because the asset's book value decreases.

Year	Depreciation	Book value	Income after depreciation expenses	Rate of return (income/assets)
0		$500,000		
1	$90,000	$410,000	$100,000	24.4%
2	$90,000	$320,000	$100,000	31.2%
3	$90,000	$230,000	$100,000	43.5%
4	$90,000	$140,000	$100,000	71.4%
5	$90,000	$50,000	$100,000	200.0%

Sum of the Years' Digits Method of Depreciation

!!! *The* ***sum of the years' digits method*** *was introduced by American accountants. It is an improvement over diminishing balance method of depreciation. Here also the depreciation charge constantly reduces. This method is normally applied to fairly long live assets. Unlike the diminishing balance method, a constantly decreasing rate is applied on the original cost. Hence the original book value is, like the straight line method, reducible to zero. The determination of the rate of depreciation is very simple. It simply sums up the years in an asset's lifespan to be used as denominator, and reverses the individual year numbers to be used as numerator.*

Example:

Suppose the cost, residual value and life of the asset are:

Cost	$75,000
Residual value	$3,000
Life of the asset	8 Years

The denominator will be:

$$1 + 2 + 3 + 4 + 5 + 6 + 7 + 8 = 36.$$

The numerators from the first to the 8th year will respectively be:

$$8 + 7 + 6 + 5 + 4 + 3 + 2 + 1.$$

Applying the rate to the depreciable cost 'original cost – residual value', i.e. $72,000, the depreciation charges for the first eight years will be:

Year	Opening book value	Depreciable cost	Rate	Depreciation	Total depreciation	Written down value
1	75,000	72,000	8/36	16,000	16,000	59,000
2	59,000	72,000	7/36	14,000	30,000	45,000
3	45,000	72,000	6/36	12,000	42,000	33,000
4	33,000	72,000	5/36	10,000	52,000	23,000
5	23,000	72,000	4/36	8,000	60,000	15,000
6	15,000	72,000	3/36	6,000	66,000	9,000
7	9,000	72,000	2/36	4,000	70,000	5,000
8	5,000	72,000	1/36	2,000	72,000	3,000

Formula:

The sum of year's digits can be easily computed by the following formula:

$$S = n\,(n + 1)/2,$$

where S = sum of years;

n = number of years of useful life of assets.

Let's apply it when n = 8 years:

$$S = 8\,(8 + 1)/2 = 72/2 \text{ or } 36.$$

Reducing Balance Method of Depreciation

!!! *Under the* ***reducing balance method****, the depreciation is charged at a fixed rate like the straight line method (also known as the fixed installment method). But the rate is not calculated on cost of an asset as it is done under the fixed installment method – it is calculated on the book value of an asset. The book value of an asset is obtained by deducting depreciation from its cost. The book value of an asset gradually reduces on account of charging depreciation. Since the depreciation rate is applied on reducing balance of an asset, this method is called reducing balance method or diminishing balance method.*

Example:

Suppose the cost of an asset is $1,000 and the rate of depreciation is 10% p.a.

Cost of asset	1,000
Depreciation:	
1st year: 10% of 1,000	100
	_____
Book value	900
2nd year: 10% of 900	90
	_____
Book value	810
3rd year: 10% of 810	81
	_____
Book value	729
and so on.......	

Under the fixed installment method the amount of annual depreciation remains the same but under the reducing balance method the amount of annual depreciation gradually reduces.

This method is especially suitable to assets with long life, e.g., plant and machinery, furniture, motor car etc.

Under this method the real cost of using an asset is the depreciation and repair expenses so this method gives better results because in early years when repair expenses are less the depreciation is more. As the asset gets older repair charges on it increase and the amount of depreciation decreases. So the combined effect of both these costs remains almost constant on the profit and loss each year.

The great weakness of this method is that it takes very long time to write off an asset to approximately nil, unless a very high rate is used, in which case the burden on earlier years shall be excessive. This method is used by income tax authorities for granting depreciation allowance to assess.

Formula for the Calculation of Depreciation Rate:

The calculation of correct rate of depreciation is very important under this method. The following formula should be applied under given conditions.

When the cost of an asset, residual value and useful life of an asset is given:

$$r = 1 - (S/C)^{1/n},$$

where r = Rate of depreciation;

n = Estimated useful life of an asset;

S = Residual value after the expiry of useful life;

C = Original cost of an asset.

Example 2:

If n = 3 years, S = 64,000 and C = 1,000,000, calculate the rate of depreciation:

$$r = 1 - (64{,}000/1{,}000{,}000)^{1/3} = 1 - 40/100 = 60/100 = 60\%.$$

Disposal of Fixed Assets

Company purchased a machine for $2000 on 1st January 2011 which had its useful life of 5 years and an estimated residual value of $500. The machine was being depreciated on straight line basis. However, Company decided to sell the asset on1 January 2013 for $1500 in order to raise cash for the purchase of a new machine.

The disposal of the fixed asset will be recorded as follows:

1. Record cash received or the receivable arising from the sale:

– Debit;

– Cash;

– $1500.

2. Remove the asset from the balance sheet:

– As a fixed asset is recognized in the balance sheet at the Net Book Value (i.e. Cost less Accumulated Depreciation), the machine will be removed from the accounts of Company in two parts:

– **First,** the Machine Cost must be removed by crediting the ledger:

– Credit;

– Machine Cost;

– $2000.

– **Second,** the Accumulated Depreciation in respect of the machine must be removed by debiting the ledger:

– Debit;

– Accumulated Depreciation;

– $600;

– Accumulated Depreciation: (2000 – 500)/5 × 2 years;

– The combined effect of the above two transactions would be to remove the machine's net book value of $1400 (2000 – 600) from the balance sheet;

– The combined effect of the above two transactions would be to remove the machine's net book value of $1400 (2000 – 600) from the balance sheet.

3. Recognize the resulting gain or loss on the sale of machine:

– Company received $1500 for an asset with a balance sheet worth of $1400. It therefore earned a gain of $100. The gain will be recorded as follows:

– Credit;

– Gain on Disposal;

– $100.

The accounting entries will appear in the Company's ledger accounts as follows:

Machine Cost					
Debit		$	Credit		$
2011	Cash	2000	2013	Disposal	2000
		2000			2000

Accumulated Depreciation					
Debit		$	Credit		$
2013	Disposal	600	2011	Income Statement	300
			2012	Income Statement	300
		600			600

Cash Book					
Debit		$	Credit		$
2013	Disposal	1500	–	–	–

Disposal Account					
Debit		$	Credit		$
2013	Machine cost	2000	2013	Cash	1500
	Income Statement (Gain)	100		Accumulated Depreciation	600
		2100			2100

Disposal Account acts as a control account for the entries involving the disposal of fixed assets. Balances from all relevant fixed asset accounts are pooled into the disposal account and the balancing figure is the gain or loss on disposal which is transferred to the income statement.

Account of long-term liabilities

*!!! **Long term liabilities** are obligations that are due for one year or longer after the end of the period. Since the time value of money can be large, long term liabilities are often valued at their present value, while current liabilities are at nominal value.*

At the beginning of the year, the firm has a loan of $10,000. The interest rate is 5%. At the end of the year, $500 of interest is paid.

The journal entry of the interest expense:

T-account	Debit	Credit	
Interest expense	500		
Cash		500	

Then, the firm decides to sell a machine and use the proceeds of 4,000 to partially pay down the loan.

The journal entry of this payment:

T-account	Debit	Credit	
Note payable	4,000		
Cash		4,000	

!!! ***Key points***:

— long term liabilities are (normally) valued at present value;

— when a liability is interest-bearing, the passing in time will result in interest expenses;

— when money is paid (or products delivered/services rendered), the liability is reduced.

QUESTIONS FOR SELF-ASSESSMENT

1. What are the ways to value inventory?
2. What is the difference between liability and debt?
3. What is the proper use of the words *lend* and *borrow*?
4. What are accruals?
5. What is the meaning of net assets?
6. Where is a contingent liability recorded?
7. What is historical cost?
8. What is a creditor?
9. What is reported as property, plant and equipment?
10. Why does LIFO usually produce a lower gross profit than FIFO?
11. What is the cost of sales?
12. What is FIFO?
13. What is the difference between cost and expense?
14. What is a contra asset account?
15. Why isn't land depreciated?
16. How are fully depreciated assets reported on the balance sheet?
17. What is book value?

TASKS FOR SELF-ASSESSMENT

5.9. Determine the cost of goods sold by LIFO method based on the original data.

470 goods have been sold. Their cost is:
1. Beginning Inventory: 270 units × \$15;
2. Purchase One: 100 units × \$18;
3. Purchase Two: 100 units × \$20.

5.10. Determine the cost of goods sold by FIFO method based on the original data.

470 goods have been sold. Their cost is:
1. Beginning Inventory: 270 units × \$15;
2. Purchase One: 100 units × \$18;
3. Purchase Two: 100 units × \$20.

5.11. Determine the cost of goods sold by the weighted-average cost flow method based on the original data.

470 goods have been sold. Their cost is:
1. Beginning Inventory: 270 units × \$15;

2. Purchase One: 100 units × \$18;
3. Purchase Two: 100 units × \$20.

5.12. Calculate the depreciation on fixed assets using the method of straight line of depreciation based on the original data.

The machine was bought for \$800,000 and we thought we would keep it for eight years and then sell it for \$80,000 (salvage value).

5.13. Calculate the depreciation on fixed assets using sum of the years' digits method of depreciation based on the original data.

The machine was bought for \$800,000 and we thought we would keep it for eight years and then sell it for \$80,000 (salvage value).

5.14. The construction company buys raw materials such as sand and clay in bulk and stores it in a central warehouse from where materials are issued to project sites as required. Which of the following methods is most appropriate for valuing inventory?

1. Actual Unit Cost Method;
2. LIFO Method;
3. FIFO Method;
4. AVCO Method.

Unit 6
DETERMINATION AND CALCULATION OF INCOME, COSTS AND EARNINGS OF A BUSINESS IN FOREIGN COUNTRIES

TOPICS FOR DISCUSSION

1. Accounting and accrued income.
2. Accounting and accrued expense.
3. Accounting and prepaid income.
4. Accounting and prepaid expense.
5. Cost-volume-profit (CVP) analysis (the equation technique and break-even point; the contribution of margin technique in CVP analysis).

TASKS

6.1. Choose the correct option (a, b or c).

1. Which of the following would not be included in a product's cost for inventory valuation for the financial statements?
a) Factory Supplies;
b) Quality Control;
c) Interest Expense.

2. Which would be the least favorable basis for allocating manufacturing overhead for a factory with automated equipment and a significant variation of services by its indirect labor?
a) ABC;
b) Direct Labor Hours;
c) Machine Hours.

3. Which would be the most favorable basis for allocating manufacturing overhead for a factory with automated equipment and a significant variation of services by its indirect labor?
a) ABC;

b) Direct Labor Hours;
c) Machine Hours.

4. Activity-based costing will provide greater accuracy when allocating costs than a manufacturer's machine hours when its products and customers are ___________ diverse.
a) Less;
b) More.

5. When using machine hours for allocating manufacturing overhead (instead of activity-based costing), a low-volume item requiring a significant amount of special handling will be assigned too ___________ manufacturing overhead.
a) Little;
b) Much.

6. In ABC the assumption is that ___________ use resources or cause costs.
a) Activities;
b) Products.

6.2. Choose the correct option (True or False).

1. Activity based costing is considered to be a traditional costing method.
a) True;
b) False.

2. Under ABC, indirect manufacturing costs are predominantly assigned on the basis of direct machine hours.
a) True;
b) False.

3. The cost to set up production equipment is best allocated directly to products via machine hours.
a) True;
b) False.

4. Setup cost is an example of a batch-level cost.
a) True;
b) False.

5. Manufacturing costs are often organized in the general ledger by function and department. When applying activity-based costing, these manufacturing costs will be sorted by activities.

a) True;

b) False.

6. In activity-based costing, the manufacturing overhead cost per unit will depend partially on the number of units in a batch.

a) True;

b) False.

7. If products are uniform and customers are similar in their demands, activity-based costing may not offer a significant advantage over machine hours when assigning overhead.

a) True;

b) False.

8. A product with a high gross profit could be an unprofitable product.

a) True;

b) False.

9. Activity-based costing can be used to allocate SG&A expenses in order to assist management with pricing and other marketing decisions.

a) True;

b) False.

6.3. «Alfa» Company has a year end of 31st December 2012. Which of the following transactions and events should result in the recognition of accrued income in «Alfa» Company's financial statements? Explain your answer.

a) «Alfa» Company receives rent income in advance. Rent for the first quarter of 2013 is due on 31st December 2012.

b) «Alfa» Company receives interest of $10,000 on bank deposit for the month of December 2012 on 3rd January 2013.

Solution: *b) «Alfa» Company receives interest of $10,000 on bank deposit for the month of December 2012 on 3rd January 2013*.

!!! Financial statements are prepared under the Accruals Basis of accounting which requires that income and expense must be recognized in the accounting periods to which they relate rather than on cash basis. An exception to this general rule is the cash flow statement whose main purpose is to present the cash flow effects of transaction during an accounting period.

«Alfa» Company will recognize interest income of $10,000 in the financial statements of year 2012 even though it was received in the next accounting period as it relates to the current period. Following accounting entry will need to be recorded to account for the interest income accrued:

Date	Particular	L.F	Amount	Amount
2012				
Dec. 31	Interest Income Receivable Interest on Bank Deposit (Income) (The interest income accrued)		10,000	 10,000

On the date of receipt of interest (i.e. 3rd January of the next year) following accounting entry will need to be recorded in the subsequent year:

Date	Particular	L.F	Amount	Amount
2013				
Jan. 3	Bank Interest Income Receivable (The interest income receivable)		10,000	 10,000

6.4. «Alfa» Company has a year end of 31st December 2012. Which of the following transactions and events should give rise to accrued expense in «Alfa» Company's financial statements? Explain your answer.

a) «Alfa» Company receives rent income in advance. Rent for the first quarter of 2013 is due on 31st December 2012.

b) «Alfa» Company pays loan interest of $10,000 for the month of December 2012 on 3rd January 2013.

Solution: *b) «Alfa» Company pays loan interest of $10,000 for the month of December 2012 on 3rd January 2013.*

!!! *Accrued expense is expense which has been incurred but not yet paid.*

Expense must be recorded in the accounting period in which it is incurred. Therefore, accrued expense must be recognized in the accounting period in which it occurs rather than in the following period in which it will be paid.

«Alfa» Company will recognize interest expense of $10,000 in the financial statements of 2012 even though it was paid in the next accounting period as it relates to the current period. Following accounting entry will need to be recorded to account for the interest expense accrued:

Date	Particular	L.F	Amount	Amount
2012				
Dec. 31	Interest Expense Interest Payable (The interest expense accrued)		10,000	 10,000

On the date of payment of interest (i.e. 3rd January of the next year) following accounting entry will need to be recorded in the subsequent year:

Date	Particular	L.F	Amount	Amount
2013				
Jan. 3	Interest Payable Cash (The interest Payable)		10,000	 10,000

6.5. «Alfa» Company has a year end of 31st December 2012. Which of the following transactions and events should recognize a liability of $10,000 in «Alfa» Company's financial statements? Explain your answer.

a) «Alfa» Company pays loan interest of $10,000 for the month of December 2012 on 3rd January 2013.

b) «Alfa» Company receives rent income in advance. Rent for the first quarter of 2013 is due on 31st December 2012.

Solution: *b) «Alfa» Company receives rent income in advance. Rent for the first quarter of 2013 is due on 31st December 2012.*

!!! *Prepaid income is revenue received in advance but which is not yet earned. Income must be recorded in the accounting period in which it is earned. Therefore, prepaid income must not be shown as income in the accounting period in which it is received but instead it must be presented as such in the subsequent accounting periods in which the services or obligations in respect of the prepaid income have been performed.*

«Alfa» Company will recognize a liability of $10,000 in the financial statements of 2012 in respect of the prepaid income to acknowledge its obligation to make the office space available to the tenant in the following year. Following accounting entry will be recorded in the books of «Alfa» Company in 2012:

Date	Particular	L.F	Amount	Amount
2012				
Dec. 31	Cash Prepaid Rent Income (Liability) (Acknowledge obligation)		10,000	 10,000

The prepaid income will be recognized as income in the next accounting period to which the rental income relates. The following accounting entry will be recorded in 2013:

Date	Particular	L.F	Amount	Amount
2013				
Mar. 31	Prepaid Rent Income (Liability). Rent Income (Income Statement) (The Rent Income)		10,000	 10,000

6.6. «Alfa» Company has a year end of 31st December 2012. Which of the following transactions and events should lead to recognition of prepaid expense in «Alfa» Company's financial statements? Explain your answer.

a) «Alfa» Company receives rent income in advance. Rent for the first quarter of 2013 is due on 31st December 2012.

b) «Alfa» Company pays advance rent to its landowner of $10,000 on 31st December 2012 in respect of office rent for the following year.

Solution: *b) «Alfa» Company pays advance rental of $10,000 to its landowner on 31st December 2012 in respect of office rent for the following year.*

!!! *Prepaid expense is expense paid in advance but which has not yet been incurred. Expense must be recorded in the accounting period in which it is incurred. Therefore, prepaid expense must not be shown as expense in the accounting period in which it is paid but instead it must be presented as such in the subsequent accounting periods in which the services in respect of the prepaid expense have been performed.*

«Alfa» Company will recognize an asset of $10,000 in the financial statements of 2012 in respect of the prepaid expense to recognize its right to use office space in the following year. The following accounting entry will be recorded in the books of «Alfa» Company in 2012:

Date	Particular	L.F	Amount	Amount
2012				
Dec. 31	Prepaid Rent Cash (Prepaid Expense)		10,000	 10,000

The prepaid expense will be recognized as expense in the next accounting period to which the rental expense relates. The following accounting entry will be recorded in 2013:

Date	Particular	L.F	Amount	Amount
2013				
...	Rent Expense (Income Statement) Prepaid Rent (The Rent Expense)		10,000	 10,000

6.7. Match each object (1-3) with two of its components (a-c).

Term	Explanation
1. Scatter-graph method	a. When using this method, the highest point and the lowest point are used to create the cost formula. The high point is defined as the point with the highest activity and the low point is defined as the point with the lowest activity.

Table

Term	Explanation
2. High-low method	b. This method involves estimating the fixed and variable elements of a mixed cost visually on a graph.
3. Method of least squares	c. This method requires the use of 30 or more past data observations for both the activity level (in units) and the total costs.

6.4. Illustration of the methods for separating mixed costs.

Example of high-low method:

Let us assume that «Alfa» Company incurred the following costs during the past six months:

Total costs of «Alfa» Company over the past six months

Month	Vales Production	Total Cost
July	10,000	$44,000
August	15,000	$60,000
September	23,000	$85,000
October	21,000	$75,000
November	19,000	$70,000
December	28,000	$98,000

The lowest level of production was in July and the highest level of production was in December. The difference between the number of units produced and the difference between the total cost at the highest and lowest levels of production are shown below:

	Production	Total Cost
Highest Level	28,000 units	$98,000
Lowest Level	10,000 units	$44,000
Difference	**18,000 units**	**$54,000**

As the total fixed cost does not change with changes in the production volume, the difference in the total costs represents the change in the total variable costs. So, if we divide the difference in the total costs by the difference in the production levels, we will have an estimate of the variable cost per unit:

Variable Cost per Unit = $54,000 ÷ 18,000 units = $3.

The variable cost per unit is \$3. The fixed cost will be the same at both the highest and lowest levels of production because fixed costs don't change. In order to estimate the fixed costs, we have to subtract the estimated total variable cost from the total cost:

Total Cost = Variable Cost per Unit x Units of Production + Fixed Cost.

Highest level:

\$98,000 = \$3 × 28,000 + Fixed Cost,

Fixed Cost = \$14,000.

Lowest level:

\$44,000 = \$3 × 10,000 + Fixed Cost,

Fixed Cost = \$14,000.

The fixed costs equal \$14,000. Knowing the fixed costs and the variable cost per unit we can estimate the total costs for the planned production level by using the formula below:

$$\boldsymbol{T = F + V \times N},$$

where $\boldsymbol{T}$ is the total cost;
$\boldsymbol{F}$ is the fixed cost;
$\boldsymbol{V}$ is the variable cost per unit;
$\boldsymbol{N}$ is the number of units to be produced.

Using the formula presented above and the fixed cost and variable cost per unit, we obtain the following formula for our example:

$$T = \$14{,}000 + \$3 \times N.$$

Example of scatter-graph method:

Let us again use the example of «Alfa» Company and review their activities for the past six months. The first step is to plot the points on a graph. Then draw a line that most closely represents a straight line composed of all the data points. The graph using data points is given below.

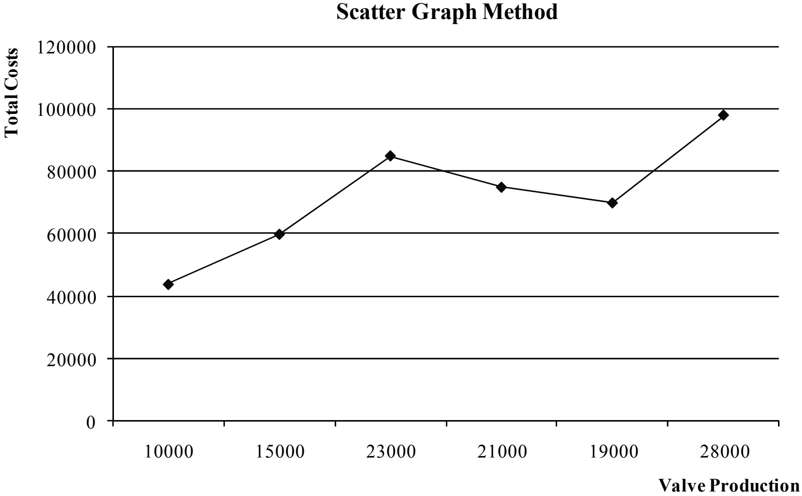


Fig. 6.1. Scatter graph of the results of «Alfa» Company activities for the six months

The point where this line intersects the vertical axis is the fixed costs, or \$14,000 in our case. The angle (slope) of the line can be calculated to give a fairly accurate estimate of the variable cost per unit. We can see from the graph that production of 20,000 valves will cost Friends Company \$75,000 and production of 25,000 valves will cost \$90,000. Knowing this information we can calculate the variable cost per unit:

$$\frac{Y2 - Y1}{X2 - X1} = \frac{\$90{,}000 - \$75{,}000}{25{,}000 - 20{,}000} = \frac{\$15{,}000}{5{,}000} = \$3.$$

When the two variables become known, we can use them in the cost formula:

$$\boldsymbol{Y} = \boldsymbol{F} + \boldsymbol{V} \times X,$$

where F is the fixed cost;
V is the variable cost per unit;
X is the production level.

So, the cost formula looks like this:

$$\boldsymbol{Y} = \$14{,}000 + \$3 \times \boldsymbol{X}.$$

Using this formula we can calculate the total costs of activity in the range of 10,000 to 28,000 valves per month and then separate them into fixed and variable components. For example, assume that production of 24,000 valves is planned for the next period. Using the formula we can determine that the total costs would be:

$$Y = \$14{,}000 + \$3 \times 24{,}000 = \$86{,}000.$$

\$14,000 is fixed and \$72,000 is variable, for a total of \$86,000 (\$14,000 + \$72,000).

6.4. Determine the level of sales necessary to cover all expenses of the base of the equation technique in CVP analysis.

We have just seen how to calculate the volume of minimum sales in units and dollars to break-even (i.e., have zero profits). What if we want to know how many valves have to be sold to earn a \$30,000 profit? What about a \$40,000 profit?

The answer can be found by using the same equation we used before:

Sales = Variable Costs + Fixed Costs + Profits.

Note that:

Sales = Sales Price per Unit × Unit Sales,
Variable Costs = Variable Cost per Unit × Unit Sales.

If we replace Sales and Variable Costs in the equation, we will get the following result:

Selling Price per Unit × Unit Sales = Variable Costs per Unit × Unit Sales +
+ Fixed Costs + Profits.

When we further rearrange the equation, we will obtain the following:

$$\textbf{Unit Sales} = \frac{\textbf{Fixed Costs + Profits}}{\textbf{Selling Price per Unit − Variable Costs per Unit}}$$

Using this formula, we can calculate how many units should be sold to generate \$30,000 in profits for «Alfa» Company:

$$\text{Unit Sales} = \frac{\$10{,}000 + \$30{,}000}{\$5 - \$3} = 20{,}000 \text{ units.}$$

The same formula can be used when the target profit is \$40,000:

$$\text{Unit Sales} = \frac{\$10{,}000 + \$40{,}000}{\$5 - \$3} = 25{,}000 \text{ units.}$$

The 20,000 and 25,000 units can be converted to dollars as follows: \$100,000 (\$5 × 20,000 units) and \$125,000 (\$5 × 25,000 units), respectively.

We can check our answers for the desired \$30,000 and \$40,000 profits by using the same formula we applied before:

Selling Price per Unit × Unit Sales
–
Variable Costs per Unit × Unit Sales
–
Fixed Costs
=
<u>Profits</u>

For the 20,000 units sold, the profits will be calculated as follows:

Profits = \$5 × 20,000 − \$3 × 20,000 − \$10,000 = \$30,000.

And for the 25,000 units sold, the profits can be determined as shown below:

Profits = 25,000 × \$5 − 25,000 × \$3 − 10,000 = \$40,000.

In both cases, we arrived at the desired level of profits and this proves that our calculations were correct.

Now when we know that we've got to sell 20,000 units (or generate \$100,000 in sales) to earn the \$30,000 profits and 25,000 units (or \$125,000) to make \$40,000 of profits, «Alfa» Company can assess (a) if it is possible considering the market situation; (b) what level of sales is more realistic in the company's situation; (c) what amount of resources the company needs; and (d) if «Alfa» Company needs to hire more employees to generate a desired level of profits.

6.5. Determine the level of sales necessary to cover all expenses of the base of the contribution margin technique in CVP analysis.

Another method used in CVP analysis is contribution margin technique.

Let's start with the definition of contribution margin.

!!! ***Contribution margin (contribution)*** *is the difference between sales and variable costs (expenses). Contribution margin contributes toward fixed cost and profits.*

Contribution margin may be calculated in total or per unit. The calculation of a contribution margin in total is as follows:

Contribution = Sales – Variable Costs.

The calculation of a contribution margin per unit is similar to the contribution calculation in total, except that all amounts are divided by the number of units:

$$\textbf{Contribution Per Unit} = \frac{\textbf{Sales – Variable Costs}}{\textbf{Unit Sales}} = \textbf{Selling Price per Unit} - \textbf{Variable Costs per Unit}.$$

For example, let's assume the following data are available for «Alfa» Company:

Sales (15,000 units x $5)	$75,000
Variable costs (15,000 units x $3)	$45,000
Fixed costs	$10,000
Number of units sold	15,000
Sales price per unit	$5
Variable cost per unit	$3

Contribution margin is calculated by using the earlier formula:

Contribution = Sales – Variable Costs = $75,000 – $45,000 = $30,000.

Contribution is $30,000, which is the amount remaining after variable costs to contribute toward (cover) fixed costs and profits.

The contribution margin per unit can be determined as shown below:

$$\text{Contribution per Unit} = \frac{\$75{,}000 - \$45{,}000}{15{,}000} = \$5 - \$3 = \$2.$$

This $2 per valve contributes toward (covers) fixed costs and profits.

Contribution margin ratio in CVP analysis

!!! ***Contribution margin ratio*** *is the contribution margin divided by the sales amount. It is the percent of sales dollars available to cover fixed costs. Once fixed costs are covered, the next dollar of sales results in a company's profits.*

Contribution margin ratio is expressed as a percent.

$$\textbf{Contribution Margin Ratio} = \frac{\textbf{Sales – Variable Costs}}{\textbf{Sales}} \times \textbf{100\%}.$$

Based on the figures from the example of Friends Company, the contribution margin ratio will comprise:

$$\text{Contribution Margin Ratio} = \frac{\$75{,}000 - \$45{,}000}{\$75{,}000} \times 100\% = 40\%.$$

The 40% calculated above means that fixed costs and profits represent 40% of total sales (because the contribution margin is fixed costs plus profits, or sales less variable costs).

Contribution margin technique in CVP analysis and break-even point

Now that we know what contribution margin and contribution margin ratio are we can use them in CVP analysis to calculate the break-even point for our «Alfa» Company example. Recall that break-even is a situation when profits equal zero. This means that contribution in this case equals fixed costs only:

Contribution = Fixed Costs + Profits = Fixed Costs + 0 = Fixed Costs.

To calculate the break-even point in units, we can use the following formula:

$$\textbf{Break-even Sales in Units} = \frac{\textbf{Fixed Costs}}{\textbf{Contribution per Unit}}.$$

Recall that contribution contributes toward (covers) fixed costs. Based on this, the equation above can also be read as «How many units do we need to sell to cover all fixed costs and have zero profit?».

To calculate the break-even point in dollars, we will use a similar formula, but will now apply the contribution margin ratio:

$$\textbf{Break-even Sales in Dollars} = \frac{\textbf{Fixed Costs}}{\textbf{Contribution Margin Ratio}}.$$

The equation above can also be read as «How much sales, in dollars, do we need to generate to cover all fixed costs and have a zero profit?»

Using these break-even formulas, the break-even sales for Friends Company can be calculated as follows:

$$\textbf{Break-even Sales in Units} = \frac{\textbf{\$10,000}}{\textbf{\$2}} = \textbf{5,000 units.}$$

If the company sells 5,000 units, it has neither loss nor profit. We can check this calculation by determining the profit when 5,000 units are sold:

Profits = Sales − Variable Costs − Fixed Costs = 5,000 × \$5 − − 5,000 × \$3 − \$10,000 = 0.

The company will make a loss if it sells fewer than 5,000 units and will generate a profit if the sales exceed 5,000 units.

The amount of break-even sales in dollars can be determined as shown below:

$$\text{Break-even Sales in Dollars} = \frac{\$10{,}000}{40\%} = \$25{,}000.$$

The break-even sales in dollars can also be determined by multiplying the 5,000 units for break-even by the selling price per unit: 5,000 × \$5 = \$25,000. As you can see, the result is the same (i.e., \$25,000).

QUESTIONS FOR SELF-ASSESSMENT

1. What is the accrued income?
2. What is the accrued expense?
3. What is the prepaid income?
4. What is the prepaid expense?
5. Can a fully depreciated asset be revalued?
6. What is the difference between financial accounting and management accounting?
7. What is the difference between accounts payable and accrued expenses payable?
8. Where is a contingent liability recorded?
9. What is interest expense?
10. Are liabilities always a bad thing?
11. What is a deferred credit?
12. What are accrued expenses and when are they recorded?
13. What is the difference between a cost and an expense?
14. What order of inventory classification reflects the manufacturing process?

TASKS FOR SELF-ASSESSMENT

6.5. A company produces towels. The following data show the company's activities during the last six months:

Month	Total Production (Units)	Total Cost ($)
January	4,000	55,500
February	6,000	84,000
March	9,000	98,000
April	8,500	93,000
May	9,500	105,000
June	7,300	88,000

The company uses the high-low method to estimate the variable cost per unit and the fixed cost component of mixed costs.

Which of these cost formulae presented below is correct for the company (i.e. T — Total cost, N — Number of units to be produced)?

a) $T = 19{,}500 + 9 \times N$;

b) $T = 9 + 19{,}500 \times N$;

c) $T = 9 \times N$;

d) $T = 49{,}500 + 9 \times N$.

6.6. Determine what the profit of the company in 2013 is, if the company sells three (3) types of products.

The following data are available:

	Product A	**Product B**	**Product C**
Share in physical volume sold, %	60%	30%	10%
Contribution margin ratio	0.5	0.4	0.2
Fixed costs total, $	$12,000		

In 2013 the company sold its products for a total of $65,000.
a) $28,600;
b) $20,500;
c) $16,600;
d) $12,050.

Unit 7
SYSTEM OF FINANCIAL RATIOS

TOPICS FOR DISCUSSION

1. Common-size analysis:
   a. Vertical common-size analysis.
   b. Horizontal common-size analysis.
2. Financial ratio analysis:
   a. Activity ratios.
   b. Liquidity ratios.
   c. Solvency ratios.
   d. Profitability ratios.

TASKS

7.1. Choose the correct option (True or False).

1. Liquidity ratios measure the degree of protection of long-term suppliers of funds.
a. True;
b. False.

2. The ideal way to compare income statement figures, such as sales, to balance sheet figures, such as receivables, is to use a measure of the average for the balance sheet figures.
a. True;
b. False.

3. Absolute figures usually have more meaning than ratio comparisons.
a. True;
b. False.

4. In order to determine the meaning of a ratio, some kind of comparison, such as an industry average or trend analysis, is helpful.
a. True;

b. False.

5. Different accounting methods can cause some ratios to differ substantially.
a. True;
b. False.

6. A service firm will usually have a low amount of inventory, consisting primarily of supplies.
a. True;
b. False.

7. Typically, the largest expense to a manufacturing firm is cost of goods sold.
a. True;
b. False.

8. The descriptive information in annual reports is not useful in statement analysis; only the financial statements themselves are of value.
a. True;
b. False.

9. Based on the terms of the credit and the purpose, the objectives of financial statement analysis by creditors will vary.
a. True;
b. False.

10. Financial statement analysis is a judgmental process.
a. True;
b. False.

11. Common-size analysis involves expressing comparisons in percentages.
a. True;
b. False.

12. When performing year-to-year change analysis, a meaningful percent change cannot be computed when one number is positive and the other number is negative.
a. True;
b. False.

7.2. Choose the correct option (a, b, c, d or e).

1. Statements in which all items are expressed only in relative terms (percentage of a base) are termed:

a) Vertical Statements;
b) Horizontal Statements;
c) Funds Statements;
d) Common-Size Statements;
e) none of the answers is correct.

2. Which of the following can offer a type of comparison in financial statement analysis?

a) past ratios and figures;
b) industry averages;
c) statistics of competitors;
d) all of the answers are correct;
e) none of the answers is correct.

3. Which of the following would not be a user of financial statements?

a) management;
b) bankers;
c) employee unions;
d) investment analysts;
e) all of the above are users.

4. Suppose you are comparing two firms in the steel industry. One firm is large and the other is small. Which type of numbers would be most meaningful for statement analysis?

a) Absolute numbers would be most meaningful for both the large and small firm;
b) Absolute numbers would be most meaningful in the large firm; relative numbers would be most meaningful in the small firm;
c) Relative numbers would be most meaningful for the large firm; absolute numbers would be most meaningful for the small firm;
d) Relative numbers would be most meaningful for both the large and small firm, especially for interfirm comparisons;
e) It is not meaningful to compare a large firm with a small firm.

5. Liquidity ratios can be used:

a) to measure the degree of protection of long-term suppliers of funds;

b) to measure borrowing capacity;
c) to measure the earning ability of a firm;
d) to measure the firm's ability to meet its current obligations;
e) to measure the worth of the firm.

7.3. Based on the ***vertical*** *common-size statement:*
a) prepare a vertical common-size analysis of this statement for each year, using sales as the base;
b) comment briefly on the changes between the two years, based on the vertical common-size statement.
Comparative income statements for 2013 and 2012 follow.

	2013	2012
Sales	$9,434,000	$7,862,000
Cost of Sales	7,075,400	5,660,640
Gross Profit	$2,358,600	$2,201,360
Operating Expenses	1,367,690	1,365,060
Operating Income	$ 990,910	$ 836,300
Interest Expense	157,500	126,000
Earnings Before Tax	$ 833,410	$ 710,300
Income Taxes	400,000	317,200
Net Income	$ 433,410	$ 393,100

Solution:
a)

	2013	2012
Sales	100.0%	100.0%
Cost of Sales*	75.0	72.0
Gross Profit	25.0	28.0
Operating Expenses	14.5	17.4
Operating Income	10.5	10.6
Interest Expense	1.7	1.6
Earnings Before Tax	8.8	9.0
Income Taxes	4.2	-4.0
Net Income	4.6%	5.0%

Cost of Sales*: ***2013***

$$\text{Cost of Sales} = \frac{\$7,075,400}{\$9,434,000} \times 100\% = 75.0\%.$$

2012

$$\text{Cost of Sales} = \frac{\$5,660,640}{\$7,862,000} \times 100\% = 72.0\%.$$

b) Cost of sales as a percentage of sales has risen substantially. This increase is nearly offset by a decline in operating expense. Interest expense and taxes have both risen slightly in relation to sales.

7.4. Using 2010 as the base year, perform a horizontal, common-size analysis. Comment on the results of the ***horizontal*** *common-size analysis.*

«XYZ» Company, a manufacturer of infants' blocks, presented the following data in its last annual report (this trend analysis begins with the year of formation, 2010).

	2013	2012	2011	2010
Sales	$61,000	$41,000	$25,000	$13,000
Cost of Sales	$41,300	$28,175	$17,201	$9,000
Net Income	$9,919	$6,412	$3,850	$2,000
Cases of Blocks Shipped	33,126	22,681	13,900	7,400

Solution:

	2013	2012	2011	2010
Sales	469.2	315.4	192.3	100.0%
Cost of Sales*	458.9	313.1	191.1	100.0%
Net Income	496.0	320.6	192.5	100.0%
Cases of Blocks Shipped	447.6	306.5	187.8	100.0%

Cost of Sales*: ***2011***

$$\text{Cost of Sales} = \frac{\$17,201}{\$9,000} \times 100\% = 191.1\%.$$

2012

$$\text{Cost of Sales} = \frac{\$28,175}{\$9,000} \times 100\% = 313.1\%.$$

2013

$$\text{Cost of Sales} = \frac{\$41{,}300}{\$9{,}000} \times 100\% = 458.9\%.$$

Comment on the results: Sales have risen rapidly. The cost of sales has risen more slowly than sales. Also, there has been a much faster rise in net income than in sales. The cases of blocks shipped have increased more slowly than sales dollars, indicating a rise in selling price or an improved mix of sales towards more expensive blocks.

7.5. Match the statements to the type of a firm and explain your choice.

The following are simplified, vertical, common-size balance sheets for three firms – a retailer, a service firm, and a manufacturer.

Assets	Firm ***A***	Firm ***B***	Firm ***C***
Cash	6.1%	8.1%	8.7%
Receivables	23.2	4.4	12.1
Inventory	31.1	1.5	24.5
Total Current Assets	60.4	14.0	45.3
Plant, Property, and Equipment (net)	30.3	83.4	51.8
Investments	9.3	2.6	2.9
Total Assets	**100.0%**	**100.0%**	**100.0%**
Liabilities and Stockholders' Equity			
Total Current Liabilities	29.3%	11.5%	21.6%
Long-Term Debt	18.1	24.8	37.8
Total Stockholders' Equity	52.6	63.7	40.6
Total Liabilities and Stockholders' Equity	**100.0%**	**100.0%**	**100.0%**

Explain:

a) Firm ***A*** is the retailing firm, due to the heavy investment in receivables and inventory with limited fixed assets. The store facilities may be rented.

b) Firm ***B*** is the service firm, due to the limited inventory.

c) Firm ***C*** is the manufacturing firm, due to the combined heavy investment in inventory and fixed assets. Also, it uses substantial long-term debt.

7.5. During the year ended December 31, 2013, «ABC» Corporation sold goods costing $324,000. Its average stock of goods during the same period was $23,432. Calculate the company's inventory turnover ratio.

Inventory turnover ratio is calculated using the following formula:

$$\textbf{Inventory Turnover Ratio} = \frac{\textbf{Cost of Goods Sold}}{\textbf{Average Inventory}}.$$

!!! ***Inventory turnover ratio*** *is used to measure the inventory management efficiency of a business. In general, a higher value of inventory turnover indicates better performance and lower value means inefficiency in controlling inventory levels. A lower inventory turnover ratio may be an indication of over-stocking which may pose risk of obsolescence and increased inventory holding costs.*

Solution:

$$\textit{Inventory Turnover Ratio} = \frac{\$324{,}000}{\$23{,}432} = \textbf{\textit{13.83.}}$$

7.6. Net credit sales of Company A during the year ended June 30, 2013 were $644,790. Its accounts receivable as of July 1, 2012 and June 30, 2013 were $43,300 and $51,730 respectively. Calculate the receivables turnover ratio.

Accounts receivable turnover is calculated using the following formula:

$$\textbf{Receivables Turnover Ratio} = \frac{\textbf{Net Credit Sales}}{\textbf{Average Accounts Receivable}}.$$

!!! *Accounts* ***receivable turnover*** *measures the efficiency of a business in collecting its credit sales. However, a normal level of receivables turnover is different for different industries. Also, very high values of this ratio may not be favourable, if achieved by extremely strict credit terms since such policies may repel potential buyers.*

Solution:

$$\textit{Average Accounts Receivable} = \frac{\$43{,}300 + \$51{,}730}{2} = \$47{,}515.$$

$$\textit{Receivables Turnover Ratio} = \frac{\$644{,}790}{\$47{,}515} = 13.57.$$

7.7. Calculate quick ratio (acid test ratio) of a company which has assets and liabilities in the year ended December 31, 2013:

Cash	$34,390
Marketable Securities	12,000
Accounts Receivable	56,200
Prepaid Insurance	9,000
Total Current Assets	111,590
Total Current Liabilities	73,780

Quick ratio is calculated using the following formula:

$$\textbf{Quick Ratio} = \frac{\textbf{Cash + Marketable Securities + Receivables}}{\textbf{Current Liabilities}}.$$

!!! ***Quick ratio*** *or Acid Test ratio is the ratio of the sum of cash and cash equivalents, marketable securities and accounts receivable to the current liabilities of a business.*

It measures the ability of a company to pay its debts by using its cash and near cash current assets (i.e. accounts receivable and marketable securities).

Solution:

$$\textit{Quick ratio} = \frac{\$(34{,}390 + 12{,}000 + 56{,}200)}{\$73{,}780} = 1.39.$$

Or:

$$\textit{Quick ratio} = \frac{\$(111{,}590 - 9{,}000)}{\$73{,}780} = 1.39.$$

7.8. Calculate debt-to-equity ratio of a business which has total liabilities of $3,423,000 and shareholders' equity of $5,493,000.

Debt-to-equity ratio is calculated using the following formula:

$$\textbf{Debt-to-Equity Ratio} = \frac{\textbf{Total Liabilities}}{\textbf{Shareholders' Equity}}.$$

> !!! ***Debt-to-equity ratio*** *is the ratio of total liabilities of a business to its shareholders' equity. It is a leverage ratio and it measures the degree to which the assets of the business are financed by the debts and the shareholders' equity of a business.*

Solution:

$$\textit{Debt-to-Equity Ratio} = \frac{\$3{,}423{,}000}{\$5{,}493{,}000} = \mathbf{0.62}.$$

7.9. Calculate total asset turnover, fixed asset turnover and working capital turnover ratios of a company which had:

- *total assets of $100;*
- *total fixed assets of $60;*
- *net working capital of $20.*

During the financial year (FY) 2013 it generated sales of $200 with cost of Goods Sold (COGS) of $160 and its total assets as of 30 December 2013 were $120. During the year it charged depreciation of $10 and there were no fixed asset additions during the year. Current assets and current liabilities were $50 and $30 as of the year end.

Following formulae are used to calculate each of the asset turnover ratios:

$$\textbf{Total Asset Turnover Ratio} = \frac{\textbf{Net Sales}}{\textbf{Average Total Assets}};$$

$$\textbf{Fixed Asset Turnover Ratio} = \frac{\textbf{Net Sales}}{\textbf{Average Fixed Assets}};$$

$$\textbf{Working Capital Turnover Ratio} = \frac{\textbf{Net Sales}}{\textbf{Average Net Working Capital}}.$$

!!! ***Asset turnover ratio*** *is the ratio of a company's sales to its assets. It is an efficiency ratio which tells how successfully the company is using its assets to generate revenue. There are a number of variants of the ratio like total asset turnover ratio, fixed asset turnover ratio and working capital turnover ratio.*

Solution:

Average total assets = (100+120)/2 = \$110, sales are \$200 so total asset turnover is \$200/\$110 = 1.82. If the industry average total asset turnover ratio is 1.2, we can conclude that the company has used its asset more effectively in generating revenue.

Opening fixed assets were \$60, closing fixed assets are \$60-\$10=\$50. Average fixed assets are hence (\$60+\$50)/2=\$55. This gives us fixed asset turnover of \$200/\$55 = 3.63

Opening working capital is \$20, closing working capital is \$20 (\$50-\$30); this gives us average working capital of \$20 and resulting working capital turnover ratio of \$200/\$20=10.

Asset turnover ratio should be looked at together with the company's financing mix and its profit margin for a better analysis as discussed in DuPont analysis.

QUESTIONS FOR SELF-ASSESSMENT

1. What is solvency?
2. What is liquidity?
3. What is turnover?
4. What is the debt-to-total assets ratio?
5. What is the fixed asset turnover ratio?
6. What is financial audit and financial analysis?
7. How do you do a financial analysis if financial statements are not provided?
8. What is the scope of financial economics and financial analysis?
9. How does financial condition analysis differ from financial statement analysis?
10. What is the free cash flow ratio?
11. What is the working capital ratio?
12. What is a liquidity ratio?
13. What is the acid test ratio?

14. What are common-size financial statements?

15. What is the difference between vertical analysis and horizontal analysis?

16. What is the quick ratio?

TASKS FOR SELF-ASSESSMENT

7.10. Coverage shows a company's ability to meet its financial obligations. The most common coverage ratios are debt and debt to equity ratios. Which of the following is not a component of debt and debt to equity ratios?

a) Shareholder's Equity;
b) Earnings before Interest and Taxes (EBIT);
c) Total Liabilities;
d) Total Assets.

7.11. Calculate the inventory turnover ratio of the business from the given information, if:

– cost of goods sold of a retail business during a year was $84,270;

– its inventory at the beginning and at the end of the year was $9,865 and $11,650 respectively.

7.12. Calculate quick ratio from the following information:

Cash	$21,720
Treasury Bills	18,500
Accounts Receivable	15,930
Prepaid Rent	6,500
Inventory	17,240
Total Current Assets	79,890
Total Current Liabilities	52,960

7.13. Calculate a debt-to-equity ratio of a business which has total liabilities of $4,562,000 and shareholders' equity of $9,568,000.

7.14. Net credit sales of Company Z during the year ended June 30, 2013 were $744,790. Its accounts receivable on July 1, 2012 and June 30, 2013 were $63,500 and $72,860 respectively. Calculate the receivables turnover ratio.

Balance Sheet: Retail/Wholesale – Sole Proprietor

!!! This balance sheet form is designed for a sole proprietorship that is in the retail or wholesale business.

Balance Sheet: Retail/Wholesale
(Sole Proprietor)

Company Name: ____________________

Balance Sheet*

As of midnight on this date: ____________________

*The balance sheet is also known as the Statement of Financial Position

ASSETS	
Current assets	
Cash & cash equivalents	$ ______
Temporary investments	______
Accounts receivable - net	______
Inventory	______
Prepaid expenses	______
Total current assets	______
Investments (long-term)	______
Property, plant & equipment	
Land	______
Land improvements	______
Buildings	______
Equipment	______
Furniture & fixtures	______
Subtotal	______
Less: Accum depreciation	(______)
Prop, plant & equip - net	______
Intangible assets	
Goodwill	______
Trade names	______
Total intangible assets	______
Other assets	______
TOTAL ASSETS	$ ______

LIABILITIES & OWNER'S EQUITY	
Current liabilities	
Notes payable	$ ______
Accounts payable	______
Wages payable	______
Accrued expenses	______
Customer deposits	______
Total current liabilities	______
Long-term liabilities	
Notes payable	______
Bonds payable	______
Total long-term liabilities	______
TOTAL LIABILITIES	______
OWNER'S EQUITY	
Sole proprietor, capital	______
Sole proprietor, drawing	(______)
Other ______	______
TOTAL OWNER'S EQUITY	______
TOTAL LIAB & OWNER'S EQUITY	$ ______

See **Filled-In Form S3** for an illustration.
Learn more about financial statements at www.AccountingCoach.com.

Balance Sheet: Services – Corporation

!!! Presenting a proper balance sheet for a corporation engaged in providing services is easy with our specialized form.

Balance Sheet: Services
(Regular corporation, no preferred stock)

© AccountingCoach.com - **Form S4**

Company Name: ______________________________

Balance Sheet*

As of midnight on this date: ______________________

*The balance sheet is also known as the Statement of Financial Position

ASSETS		LIABILITIES & STOCKHOLDERS' EQUITY	
Current assets		**Current liabilities**	
Cash & cash equivalents	$ ______	Notes payable	$ ______
Temporary investments	______	Accounts payable	______
Accounts receivable - net	______	Wages payable	______
Supplies	______	Accrued expenses	______
Prepaid expenses	______	Customer deposits	______
Total current assets	______	Total current liabilities	______
Investments (long-term)	______		
Property, plant & equipment		**Long-term liabilities**	
Land	______	Notes payable	______
Land improvements	______	Bonds payable	______
Buildings	______	Total long-term liabilities	______
Equipment	______		
Furniture & fixtures	______	TOTAL LIABILITIES	______
Subtotal	______		
Less: Accum depreciation	(______)		
Prop, plant & equip - net	______		
		STOCKHOLDERS' EQUITY	
Intangible assets		Common stock	______
Goodwill	______	Retained earnings	______
Trade names	______	Other ______	______
Total intangible assets	______	TOTAL STOCKHOLDERS' EQUITY	______
Other assets	______		
TOTAL ASSETS	$ ______	**TOTAL LIAB & STKHRS' EQUITY**	$ ______

See **Filled-In Form S4** for an illustration.
Learn more about financial statements at www.AccountingCoach.com.

Balance Sheet: Retail/Wholesale – Corporation

!!! Presenting a proper balance sheet for a company is a corporation involved in retail or wholesale operations.

Balance Sheet: Retail/Wholesale

(Regular corporation, no preferred stock)

Company Name: ______________________________

Balance Sheet*

As of midnight on this date: ______________________

*The balance sheet is also known as the Statement of Financial Position

ASSETS		LIABILITIES & STOCKHOLDERS' EQUITY	
Current assets		**Current liabilities**	
Cash & cash equivalents	$ ________	Notes payable	$ ________
Temporary investments	________	Accounts payable	________
Accounts receivable - net	________	Wages payable	________
Inventory	________	Accrued expenses	________
Prepaid expenses	________	Customer deposits	________
Total current assets	________	Total current liabilities	________
Investments (long-term)	________	**Long-term liabilities**	
		Notes payable	________
Property, plant & equipment		Bonds payable	________
Land	________	Total long-term liabilities	________
Land improvements	________		
Buildings	________	TOTAL LIABILITIES	________
Equipment	________		
Furniture & fixtures	________		
Subtotal	________		
Less: Accum depreciation	(________)		
Prop, plant & equip - net	________		
		STOCKHOLDERS' EQUITY	
Intangible assets		Common stock	________
Goodwill	________	Retained earnings	________
Trade names	________	*Less*: Treasury stock	(________)
Total intangible assets	________	TOTAL STOCKHOLDERS' EQUITY	________
Other assets	________		
TOTAL ASSETS	**$** ________	**TOTAL LIAB & STKHRS' EQUITY**	**$** ________

See **Filled-In Form S2** for an illustration.

Learn more about financial statements at www.AccountingCoach.com.

Balance Sheet: Manufacturer – Corporation

!!! This form will assure that a manufacturing corporation is presenting a professional balance sheet, including a footnote for listing the amounts of materials, work-in-process and finished goods.

Balance Sheet: Retail/Wholesale
(Regular corporation, no preferred stock)

© AccountingCoach.com - **Form S2**

Company Name: ______________________________

Balance Sheet*

As of midnight on this date: ______________________

*The balance sheet is also known as the Statement of Financial Position

ASSETS		**LIABILITIES & STOCKHOLDERS' EQUITY**	
Current assets		**Current liabilities**	
Cash & cash equivalents	$ ________	Notes payable	$ ________
Temporary investments	________	Accounts payable	________
Accounts receivable - net	________	Wages payable	________
Inventory	________	Accrued expenses	________
Prepaid expenses	________	Customer deposits	________
Total current assets	________	Total current liabilities	________
Investments (long-term)	________	**Long-term liabilities**	
		Notes payable	________
Property, plant & equipment		Bonds payable	________
Land	________	Total long-term liabilities	________
Land improvements	________		
Buildings	________	TOTAL LIABILITIES	________
Equipment	________		
Furniture & fixtures	________		
Subtotal	________		
Less: Accum depreciation	(________)		
Prop, plant & equip - net	________		
		STOCKHOLDERS' EQUITY	
Intangible assets		Common stock	________
Goodwill	________	Retained earnings	________
Trade names	________	*Less*: Treasury stock	(________)
Total intangible assets	________	TOTAL STOCKHOLDERS' EQUITY	________
Other assets	________		
TOTAL ASSETS	$ ________	**TOTAL LIAB & STKHRS' EQUITY**	$ ________

See **Filled-In Form S2** for an illustration.
Learn more about financial statements at www.AccountingCoach.com.

Income Statement: Retail/Wholesale – Sole Proprietor, Multiple-Step

!!! This form is designed for a sole proprietorship involved in retail or wholesale operations.

Income Statement: Retail/Wholesale
(Sole proprietor, multiple-step format)

© AccountingCoach.com - **Form S11**

Company Name: ____________________________________

Income Statement*

For the ____________________** Ending ____________________***

*The income statement is also known as the Statement of Operations, Profit and Loss Statement, and P&L

**Insert the time period covered: Month, Two Months, Six Months, Year, 52 weeks, 13 weeks, etc.

***Insert the ending date of the time period covered: June 30, 2013; December 31, 2012; etc.

Net sales	$ ______	**S**	
Cost of goods sold (from below)	______	**COGS**	
Gross profit	______	**GP**	(S - COGS)
Operating expenses			
SG&A expenses excluding depreciation (**Form S16**)	______		
SG&A depreciation and amortization (**Form S16**)	______		
Other operating exp: ______________________	______		
Total operating expenses	______	**OE**	
Operating income	______	**OI**	(GP - OE)
Nonoperating or other income or (expense)			
Nonoperating income/gain: ____________________	______		
Interest expense	(______)		
Other nonoperating exp: ____________________	(______)		
Loss: ________________________________	(______)		
Total nonoperating or other income or (expense)	______	**NOI**	
Net income	**$** ______	**NI**	(OI + NOI)

Cost of goods sold		
Inventory at beginning of period	$ ______	
Add: Purchases of merchandise during period	______	
Less: Purchase returns, discounts, allowances	______	
Add: Freight-in	______	
Cost of goods available	______	
Less: Inventory at end of period	______	
Cost of goods sold	$ ______	**COGS**

See **Filled-In Form S11** for an illustration.
Learn more about financial statements at www.AccountingCoach.com.

Income Statement: Retail/ Wholesale – Corporation, Single-Step

!!! This form is designed for a corporation involved in retail or wholesale operations.

Income Statement: Retail/Wholesale
(Sole proprietor, multiple-step format)

Company Name: ________________________________

Income Statement*

For the ________________** Ending ________________***

*The income statement is also known as the Statement of Operations, Profit and Loss Statement, and P&L

**Insert the time period covered: Month, Two Months, Six Months, Year, 52 weeks, 13 weeks, etc.

***Insert the ending date of the time period covered: June 30, 2013; December 31, 2012; etc.

Net sales	$ ________	**S**	
Cost of goods sold (from below)	________	**COGS**	
Gross profit	________	**GP**	(S - COGS)
Operating expenses			
SG&A expenses excluding depreciation (**Form S16**)	________		
SG&A depreciation and amortization (**Form S16**)	________		
Other operating exp: ________________	________		
Total operating expenses	________	**OE**	
Operating income	________	**OI**	(GP - OE)
Nonoperating or other income or (expense)			
Nonoperating income/gain: ________________	________		
Interest expense	(________)		
Other nonoperating exp: ________________	(________)		
Loss: ________________	(________)		
Total nonoperating or other income or (expense)	________	**NOI**	
Net income	**$** ________	**NI**	(OI + NOI)

Cost of goods sold		
Inventory at beginning of period	$ ________	
Add: Purchases of merchandise during period	________	
Less: Purchase returns, discounts, allowances	________	
Add: Freight-in	________	
Cost of goods available	________	
Less: Inventory at end of period	________	
Cost of goods sold	$ ________	**COGS**

See **Filled-In Form S11** for an illustration.
Learn more about financial statements at www.AccountingCoach.com.

Income Statement: Services – Corporation

!!! If your corporation provides services, this form will allow you to quickly and easily prepare a professional-looking income statement.

Income Statement: Services (Regular corporation)

Company Name: ____________________________________

Income Statement*

For the ____________________** Ending ____________________***

*The income statement is also known as the Statement of Operations, Profit and Loss Statement, and P&L

**Insert the time period covered: Month, Two Months, Six Months, Year, 52 weeks, 13 weeks, etc.

***Insert the ending date of the time period covered: June 30, 2013; December 31, 2012; etc.

Revenues and gains			
Operating revenues	$ ____________		
Nonoperating revenues: ____________________	____________		
Gains: ______________________________	____________		
Total revenues and gains	____________	**R**	
Expenses and losses			
Salaries, wages, fringe benefits	____________		
Independent contractors, consultants	____________		
Rent, property taxes, utilities, phone	____________		
Repairs and maintenance of building	____________		
Repairs and maintenance of equipment	____________		
Supplies	____________		
Dues and subscriptions	____________		
Advertising	____________		
Depreciation	____________		
Other operating exp: ______________________	____________		
Interest expense	____________		
Other nonoperating exp: ____________________	____________		
Loss: ____________________________________	____________		
Total expenses and losses	____________	**EXP**	
Income before income taxes	____________	**NIB4T**	(R - EXP)
Income tax expense	____________	**IT**	
Net income	**$** ____________	**NIAT**	(NIB4T - IT)

See **Filled-In Form S13** for an illustration.

Learn more about financial statements at www.AccountingCoach.com.

Income Statement: Manufacturer – Corporation, Single-Step

!!! This form has the captions and descriptions for a single-step income statement.

Income Statement: Manufacturer
(Regular corporation, single-step format, no preferred stock)

Company Name: ______________________________

Income Statement*

For the ________________** Ending ________________***

*The income statement is also known as the Statement of Operations, Profit and Loss Statement, and P&L
**Insert the time period covered: Month, Two Months, Six Months, Year, 52 weeks, 13 weeks, etc.
***Insert the ending date of the time period covered: June 30, 2013; December 31, 2012; etc.

Revenues and gains			
Sales	$ ________		
Other revenues/gains: ________________	________		
Total revenues and gains	________	R	
Expenses and losses			
Cost of goods sold (from below)	________	COGS	
SG&A expenses excluding depreciation (**Form S16**)	________		
SG&A depreciation and amortization (**Form S16**)	________		
Other operating exp: ________________	________		
Interest expense	________		
Other nonoperating exp: ________________	________		
Loss: ________________	________		
Total expenses and losses	________	EXP	
Income before income taxes	________	NIB4T	(R - EXP)
Income tax expense	________	IT	
Net income	**$** ________	**NIAT**	(NIB4T - IT)

Cost of goods sold		
Finished goods inventory at beginning of period	$ ________	
Add: Cost of goods manufactured (**Form S6**)	________	
Cost of finished goods available for sale	________	
Less: Finished goods inventory at end of period	________	
Cost of goods sold	$ ________	COGS

See **Filled-In Form S8** for an illustration.
Learn more about financial statements at www.AccountingCoach.com.

Statement of Cash Flows: Sole Proprietor, Indirect Method

!!! If your company is a sole proprietorship, you can use this form to prepare the important statement of cash flows.

Statement of Cash Flows
(Sole proprietor, indirect method)

Company Name: ______________________________

Statement of Cash Flows*

For the __________________** Ending __________________***

*The Statement of Cash Flows is also known as the Cash Flow Statement.
**Insert the time period covered: Month, Two Months, Six Months, Year, 52 weeks, 13 weeks, etc.
***Insert the ending date of the time period covered: June 30, 2013; December 31, 2012; etc.

Cash flows from operating activities		
Net income	$ ________	
Add back: Depreciation & amortization	________	
Add back: Loss on disposal of fixed assets	________	
Deduct: Gain on disposal of fixed assets	________	
Add for *decreases* in current assets:		
Accounts receivable	________	
Inventory	________	
Other current assets (other than cash)	________	
Deduct for *increases* in current assets:		
Accounts receivable	________	
Inventory	________	
Other current assets (other than cash)	________	
Add for *increases* in current liabilities:		
Accounts payable	________	
Other current liabilities	________	
Deduct for *decreases* in current liabilities:		
Accounts payable	________	
Other current liabilities	________	
Cash flows from operating activities	________	**OA**
Cash flows from investing activities		
Add: Proceeds from sale of long-term assets	________	
Deduct: Capital expenditures	________	
Deduct: Purchase of other long-term assets	________	
Cash flows from investing activities	________	**IA**
Cash flows from financing activities		
Deduct: Owner's draws	________	
Add: Investment by owner	________	
Add: Issuance of long-term debt	________	
Deduct: Repayment of long-term debt	________	
Cash flows from financing activities	________	**FA**
Change in cash and cash equivalents	**$** ________	**Net** (OA + IA + FA)
Cash and cash equivalents at beginning of period	________	
Cash and cash equivalents at end of period	$ ________	

See **Filled-In Form S18** for an illustration.
Learn more about the statement of cash flows at www.AccountingCoach.com.

Statement of Cash Flows: Corporation, Indirect Method

!!! If your company is a corporation, you can use this form to prepare the important statement of cash flows.

Statement of Cash Flows
(Regular corporation, indirect method)

Company Name: ____________________________________

Statement of Cash Flows*

For the ____________________** Ending ____________________***

*The Statement of Cash Flows is also known as the Cash Flow Statement.
**Insert the time period covered: Month, Two Months, Six Months, Year, 52 weeks, 13 weeks, etc.
***Insert the ending date of the time period covered: June 30, 2013; December 31, 2012; etc.

Cash flows from operating activities		
Net income	$ ________	
Add back: Depreciation & amortization	________	
Add back: Loss on disposal of fixed assets	________	
Deduct: Gain on disposal of fixed assets	________	
Add for *decreases* in current assets:		
Accounts receivable	________	
Inventory	________	
Other current assets (other than cash)	________	
Deduct for *increases* in current assets:		
Accounts receivable	________	
Inventory	________	
Other current assets (other than cash)	________	
Add for *increases* in current liabilities:		
Accounts payable	________	
Other current liabilities	________	
Deduct for *decreases* in current liabilities:		
Accounts payable	________	
Other current liabilities	________	
Cash flows from operating activities	________	**OA**
Cash flows from investing activities		
Add: Proceeds from sale of long-term assets	________	
Deduct: Capital expenditures	________	
Deduct: Purchase of other long-term assets	________	
Cash flows from investing activities	________	**IA**
Cash flows from financing activities		
Deduct: Cash dividends	________	
Add: Issuance of stock	________	
Add: Issuance of long-term debt including bonds	________	
Deduct: Repayment of long-term debt	________	
Cash flows from financing activities	________	**FA**
Change in cash and cash equivalents	**$** ________	**CC** (OA + IA + FA)
Cash and cash equivalents at beginning of period	________	
Cash and cash equivalents at end of period	$ ________	

See **Filled-In Form S17** for an illustration.
Learn more about the statement of cash flows at www.AccountingCoach.com.

Statement of Owner's Equity: Sole Proprietor

!!! With this form you will learn the major causes of the change in the owner's equity section of a sole proprietorship's balance sheet.

Statement of Owner's Equity
(Sole proprietor)

Name of Company: ______________________________

Statement of Changes in Owner's Equity

For the time period covering these dates: ______________________________

Balance of owner's equity at end of previous period	$ ________	**BOE**	
Add: Investments by owner	$ ________	**INV**	
Deduct: Withdrawals by owner	$ ________	**WD**	
Subtotal	**$** ________	**ST**	(BOE + INV - WD)
Add: Net income (subtract net loss) during current period	$ ________	**NI**	
Balance of owner's equity at end of current period	**$** ________	**EOE**	(ST + NI)

Other comprehensive income, beginning balance	$ ________	
Add/Deduct: Other comprehensive income/loss for period	$ ________	
Other comprehensive income, ending balance	**$** ________	**OCI**

Notes for Other Comprehensive Income (OCI):
Examples of other comprehensive income (or loss) include foreign currency translation adjustments, certain pension liability adjustments, unrealized holding gains, and the income tax expense which pertains to the comprehensive income items.

See **Filled-In Form S19** for an illustration.
Learn more about financial statements at www.AccountingCoach.com.

Simple Invoice Template

!!! It is a very straight-forward printable invoice. It has room for dates, descriptions, and prices.

Your Company Name
Address, City, State/Province, Post/Zip Code
Tel: (111) 1234-5678, Fax: (111) 1234-1234,
Email: yourname@yoursite.com,
Website: www.yoursite.com],
Tax Registration Number: 242314254235

Your Logo Here

INVOICE

Bill To	*Deliver To*	
[Customer Name] [Address] [City, State, Post Code] [Country] **Attention: [Contact Person]**	**[Customer Name]** [Address] [City, State, Post Code] [Country] **Attention: [Contact Person]**	**Invoice No#: [1001]** Date: 6 марта 2014 Your Ref # : Our Ref # : Terms: [COD]

Description	Quantity	Unit Price	Amount
		Sub Total	
Comments & Instructions:		**Tax**	
		Freight	
		Total	

Terms & Conditions:
– Please make all cheques payable to: **[Your Company Name]**

Business Invoice Template

!!! It is a printable invoice for a business. It has room for detailed purchase information such as prices and quantity.

COMMERCIAL INVOICE					
Exporter:		Date:			
		Invoice No.:			
		Performa No.:			
		Exporter's Ref.:			
		Custom's Code			
		PAN:			
Consignee/Buyer:		Buyer Order No.:			
		Shipping Date:			
		Packing:			
		No. of Boxes:			
		Markings:			
		Country of Origin:			
Scope of Supply:					
Product	Description	Quantity	Unit	Price/Unit	Total
			Sub Total		
Gross Weight:			Transport		
Net Weight:			Freight		
Volume:			Insurance		
Loading Port:			Other Chgs		
Destination Port:			TOTAL		
			Currency		
Total in Writing:					
Terms of Sale:					
Payment Terms:					
Bank Information:					
Bank Name:		Branch:			
Bank Address:					
Account Title:		Account No.:			
SWIFT:		IBAN:			
		for:			
			Authorized Signatory		

Bank Reconciliation

!!! This form lists the usual adjustments needed for the bank balance and the usual adjustments for the general ledger balance. This user-friendly form also indicates the journal entries required by the reconciliation.

Bank Reconciliation for Account____________________ © AccountingCoach.com - **Form G4**

Ending Balance on Bank Statement Dated _____________ _____, _______		$ ________	
Adjustments to Bank Statement Balance:			
Add: Deposits in transit (See Note 1 below)		+ $ ________	
Subtract: Outstanding checks listed on **Form G5**. (Also see Note 2 below.)		- $ ________	
Adjusted Balance on Bank Statement		**$** ________	**A**

Balance per Accounting Records or Check Register (as of date of bank statement):		$ ________	
Adjustments to be Entered in Accounting Records:			
Add: Additions found on bank statement that are not in accounting records:			
Interest from bank	(debit *Cash*, credit *Interest Revenue*)	+ $ ________	
Other:______________	(debit *Cash*, credit ____________________)	+ $ ________	
Other:______________	(debit *Cash*, credit ____________________)	+ $ ________	
Subtract: Deductions found on bank statement that are not in accounting records:			
Bank service charges	(debit *Miscellaneous Expense*, credit *Cash*)	- $ ________	
NSF checks	(debit *Accounts Receivable*, credit *Cash*)	- $ ________	
NSF check bank fees	(debit ____________________, credit *Cash*)	- $ ________	
Other: ______________	(debit ____________________, credit *Cash*)	- $ ________	
Other: ______________	(debit ____________________, credit *Cash*)	- $ ________	
Adjusted Balance per Accounting Records (as of date of bank statement)		**$** ________	**B**

The bank statement is reconciled when the amounts shown as **A** and **B** are identical.

Note 1. Deposits in transit are amounts received by the company as of the date of the bank statement but not yet appearing on the bank statement.

Note 2. Checks written as of the date of the bank statement but not yet appearing on any bank statement (previous or current). Use **Form G5** to list the check numbers and amounts of the outstanding checks.

See **Filled-In Form G4** for an illustration.

Learn more about bank reconciliation at www.AccountingCoach.com.

Check Request Form

!!! Obtaining the necessary information from people who need a check issued just got easier. This check request form provides space for the account numbers to be charged, the date that the check is needed, approvals, and instructions for special handling.

Check Request Form

© AccountingCoach.com - **Form G6**

Please prepare a check to the following payee:

Payee: ______________________ Check Amount: $__________ Date Needed: __________

Address: ______________________

____

____

Accounts to be Charged			
Acct. No.	Amount	Acct No.	Amount
	$		$
	$		$
	$		$
	$		$
The total of these amounts must equal the check amount.			

Requested by: ______________________

Date requested: ______________, ________

Approved by: ______________________

Date approved ______________, ________

Please attach supporting documents.

Special Handling: ____

Other: ____

Check Request Form

© AccountingCoach.com - **Form G6**

Please prepare a check to the following payee:

Payee: ______________________ Check Amount: $__________ Date Needed: __________

Address: ______________________

____

____

Accounts to be Charged			
Acct. No.	Amount	Acct No.	Amount
	$		$
	$		$
	$		$
	$		$
The total of these amounts must equal the check amount.			

Requested by: ______________________

Date requested: ______________, ________

Approved by: ______________________

Date approved: ______________, ________

Please attach supporting documents.

Special Handling: ____

Other: ____

Money Counter's Tally

!!! Accounting for the ending cash is standardized with this form. Reviewing the ending cash is simpler, faster, and more accurate when the amounts are organized.

Money Counter's Tally © AccountingCoach.com - **Form G12**

Day & Date: __________ __________ _____, _____
Day of Week Date

Comments: ______________________________

Currency

$100's	$________.00	
$50's	$________.00	
$20's	$________.00	
$10's	$________.00	
$5's	$________.00	
$2's	$________.00	
$1's	$________.00	
Total currency		**$__________.00**

Coins

Pennies	$______.___	
Nickels	$______.___	
Dimes	$______.___	
Quarters	$______.___	
Half-dollars	$______.___	
Other	$______.___	
Total coins		**$__________.___**

Checks	$______.___	
	$______.___	
Total from list:	$______.___	
Total checks		**$__________.___**
Credit Card		**$__________.___**
Coupons		**$__________.___**
Other: __________________		**$__________.___**
Total including starting cash		**$__________.___**
Less: starting cash		- **$__________.___**
Net receipts		**$______________**

Money Counter's Tally © AccountingCoach.com - **Form G12**

Day & Date: __________ __________ _____, _____
Day of Week Date

Comments: ______________________________

Currency

$100's	$________.00	
$50's	$________.00	
$20's	$________.00	
$10's	$________.00	
$5's	$________.00	
$2's	$________.00	
$1's	$________.00	
Total currency		**$__________.00**

Coins

Pennies	$______.___	
Nickels	$______.___	
Dimes	$______.___	
Quarters	$______.___	
Half-dollars	$______.___	
Other	$______.___	
Total coins		**$__________.___**

Checks	$______.___	
	$______.___	
Total from list:	$______.___	
Total checks		**$__________.___**
Credit Card		**$__________.___**
Coupons		**$__________.___**
Other: __________________		**$__________.___**
Total including starting cash		**$__________.___**
Less: starting cash		- **$__________.___**
Net receipts		**$______________**

Depreciation: Straight-line Method

!!! To calculate the method of depreciation is most commonly used on an organization's financial statements.

Depreciation: Straight-line Method © AccountingCoach - **Form D1**

Depreciation is the allocation of the cost of a plant or fixed asset (equipment, building, truck, etc.) to expense over the useful life of the asset. Straight-line depreciation means the same amount of depreciation expense for each full year.

Straight-line depreciation expense for a full year =
(Cost of the asset *minus* the **expected salvage value)**
divided by the **years of useful life**

Calculation of **straight-line depreciation expense** for one full year:

Cost of asset	$ ________	**C**	
minus Expected salvage value	$ ________	**ES**	
= Depreciable cost	$ ________	**DC**	(C - ES)
Years of useful life	________	**YRS**	
Depreciation expense for full year	**$** ________	**DE**	(DC / YRS)

or

Alternative calculation of **straight-line depreciation expense** for one full year:

Depreciable cost (from above)	$ ________	**DC**	
times Asset's straight-line depreciation rate	________ %	**SR**	(from below)
Depreciation expense for full year	**$** ________	**DE**	(DC x SR)

Journal entry for each full year of depreciation:

debit Depreciation expense	________ **DE**		
credit Accumulated depreciation		________ **DE**	

Notes:
The depreciation recorded in the general ledger and reported on the financial statements is usually different from the amounts reported on the company's tax return.

DE Plant assets purchased in the middle of the accounting year will have one-half of a year's depreciation expense in the year it is acquired.

SR Calculation of straight-line depreciation rate per year:

Constant	100%		
divided by Years of asset's useful life	________	**YRS**	
Straight-line depreciation rate per year	________ %	**SR**	(100% / YRS)

An asset with a 25 year life will have a straight-line depreciation rate of 4% per year (100% / 25 yrs.).
An asset with a 5 year life will have a straight-line depreciation rate of 20% per year (100% / 5 yrs.).

See **Filled-In Form D1** for an illustration.
Learn more about depreciation at www.AccountingCoach.com

Depreciation: Sum of the Years' Digits Method

!!! This form provides the lines in which you enter amounts for calculating the sum of the years' digits method of depreciation.

Depreciation: Sum of the Years' Digits Method

Depreciation is the allocation of the cost of a plant or fixed asset (equipment, building, truck, etc.) to expense over the useful life of the asset. The sum of the years' digits (SYD) method is an accelerated method of depreciation. This means that the amount of depreciation expense in the early years of the asset's life is greater than the amount using the straight-line method. The depreciation expense in later years will be less than the original straight-line amount. The total depreciation expense over the life of the asset will be the same under any depreciation method: cost minus the estimated salvage value.

Sum of the years' digits (SYD) depreciation expense for one full year of the asset's life = **Asset's depreciable cost** *times* (asset's **years of life remaining** at the beginning of the year *divided by* the **sum of the years' digits**)

Calculation of the **sum of the years' digits (SYD) depreciation expense** for one full year:

Cost of asset	$ ________	**C**	
minus Estimated salvage value	$ ________	**ES**	
= Depreciable cost	$ ________	**DC**	(C - ES)
times SYD fraction	________	**F**	(see below)
= **Depreciation expense for full year**	**$** ________	**DE**	(DC x F)

Journal entry for a full year's depreciation:

debit	Depreciation expense	________ **DE**	
credit	Accumulated depreciation		________ **DE**

Notes:

F The SYD fraction has as its *denominator* the total of the digits from 1 through the number of years of the asset's life. For example, if an asset has a 5-year life, the denominator will be 15 (1 + 2 + 3 + 4 + 5). If an asset's life is 10 years, the denominator will be 55 (1 + 2 + 3 + 4 + 5 + 6 + 7 + 8 + 9 + 10).

The *numerator* in the SYD fraction will be the number of years of life remaining as of the beginning of the year. For example, an asset with a 5-year life will have a numerator of 5 at the time it is placed into service. At the beginning of the second year of the asset's life, its numerator will be 4, and so on.

This means that the depreciation expense in the first year of a 5-year asset's life will be 5/15 of the asset's depreciable cost. The second year will be 4/15; the third year will be 3/15; the fourth year will be 2/15; and the fifth year will be 1/15.

The SYD fraction for an asset with a 10-year life will be 10/55 in the first year of the asset's life, 9/55 in its second year, 8/55 in its third, and so on.

See **Filled-In Form D3** for an illustration.

Learn more about depreciation at www.AccountingCoach.com.

Inventory: Estimating Lost or Missing Amounts

!!! This form, along with the form Inventory: Estimating Using the Gross Profit Method, helps you determine the approximate cost of inventory that is missing. This is done by comparing two amounts: 1) the estimated cost of inventory that is expected to be on hand, compared to 2) the cost of the actual inventory that is on hand.

Inventory: Estimating Lost or Missing Amounts
(by using the gross profit method)

The amount of missing inventory can be estimated by using the gross profit method or the retail method. The missing amounts of inventory could be due to shoplifting, theft by employees, fire loss, or other causes.

The gross profit method uses an assumed gross profit percentage or gross margin ratio (gross profit dollars divided by the sales dollars).

The difference between the estimated inventory under the gross profit method and the actual inventory on hand is the estimated *cost* of missing inventory.

Calculation of the **estimated cost of missing inventory**:

Estimated ending inventory at cost (calculated on **Form G9**)	$ ________	**EST**	
Minus: Actual ending inventory at cost from physical inventory	$ ________	**ACT**	
Estimated cost of missing inventory	**$** ________	**MISS**	(EST - ACT)

See **Filled-In Form G10** for an illustration.
Learn more about inventory at www.AccountingCoach.com.

Standard Costing: Direct Materials Price Variance

!!! This form helps you to compare two amounts: 1) the actual cost that a company paid to suppliers for materials, compared to 2) the company's standard cost of those materials. The difference is the favorable or unfavorable purchase price variance for the materials received.

Direct Materials Price Variance - **Form G15**

(Computed at time of purchase for standard costing.)

This form assumes that the unit of measure is a pound (lb.). However, it could be gallons, liters, board feet, etc.
This form assumes that the price variance of the materials is recorded at the time of purchase (not at the time of use).

Example: A company uses one raw material with a standard cost of $____________ per pound. The purchase price variance is recorded at the time that the material is placed into its materials inventory at the standard cost. The company ordered and received ______________ pounds of material at an actual cost of $____________ per lb.

Actual Amounts Charged by Suppliers/Vendors (Credit: Accounts Payable)				**Amount Recorded in Materials Inventory at Standard Cost** (Debit: Materials Inventory or Purchases)		
Actual lbs. purchased	X	Actual cost per lb.		Actual lbs. purchased	X	**Standard cost per lb.**
	X	$			X	$
	$				$	

Materials Purchase Price Variance = $ ____ Favorable or Unfavorable

See **Filled-In Form G15** for an illustration.
Learn more about standard costing at www.AccountingCoach.com.

Standard Costing: Direct Materials Usage Variance

!!! This form gives you the layout to calculate the usage variance associated with materials. The important first step guides you to calculate the quantity of materials that should have been used for the good output. The remaining steps are clearly presented so that you can easily see the materials usage variance.

Direct Materials Usage Variance
(For Standard Costing)

© AccountingCoach.com - **Form G16**

This form assumes that the unit of measure is a pound (lb.). However, it could be gallons, liters, board feet, etc.

Example: A company has one raw material with a standard cost of $____________ per pound. The standard for manufacturing each unit of output/product is __________ lbs of material. The material has a standard cost of _________ per lb. During the current period ______________ units of output were manufactured. The actual lbs. of materials used to produce the _____________ units of output amounted to ______________ lbs.

The output of _____________
units of product
will have the following
Standard Cost of Direct Materials Assigned to the Products:

Actual lbs. Used X Standard Cost per lb.

Actual lbs. Used	X	Standard cost per lb.
	X	$
$		

Standard lbs. for Output	X	**Standard cost per lb.**
	X	$
$		

Materials Usage Variance = $ Favorable or Unfavorable

See **Filled-In Form G16** for an illustration.
Learn more about standard costing at www.AccountingCoach.com.

Working Capital to Total Assets

!!! Calculating the working capital to total assets ratio is easy when you enter your company amounts on the lines next to our preprinted descriptions.

Working Capital Turnover Ratio © AccountingCoach.com - **Form R3**

Working capital turnover ratio = Total net sales or revenues for the year divided by the **average working capital during the year**

Calculation of **working capital turnover ratio** includes:

Total revenues from the income statement for the year ended ____________________.

Average working capital is computed from the balance sheets during the year.

Total net sales or revenues for the year	$ ____________	**S**	
divided by average working capital	$ ____________	**AWC**	
= Working capital turnover ratio	____________ **: 1**		(S / AWC)

Notes:

The working capital ratio is also known as *net working capital to net sales*.

S Total net sales or revenues are taken directly from the income statement for the period noted above.

AWC Since the *average* amount of working capital during the year is needed, you will need to first compute the amount of working capital on each balance sheet. Working capital is the amount of current assets minus the amounts of current liabilities (**Form R1**).

Next, you need to compute the average amount of working capital during the year. If the amount of working capital is approximately the same each period, a simple average of the amount at the beginning of the year and the amount at the end of the year will be sufficient. If the amount of working capital varies significantly from month to month, a 13-month average should be used. See **Form G3**.

See **Filled-In Form R3** for an illustration.

Learn more about financial ratios at www.AccountingCoach.com.

Contribution Margin Calculations

!!! This form makes certain that you subtract all of a company's variable costs from its revenues when calculating the contribution margin.

Contribution Margin Calculations © AccountingCoach.com - **Form B4**

Total contribution margin in $ = Total sales or revenues minus **all variable costs and expenses**

Calculation of the **total contribution margin in dollars*** for the following time period: ____________________ (month, year, etc.)

Total sales or revenues	$ ______________	**S**
minus all variable costs and expenses	$ ______________	**V**
= Total contribution margin in dollars	**$** ______________	**CM$** (S - V)

Contribution margin ratio **= Total contribution margin in dollars** divided by **total sales or revenues**

Calculation of the **contribution margin ratio**

Total contribution margin in dollars	$ ______________	**CM$**
divided by total sales or revenues	$ ______________	**S**
= Contribution margin ratio	______________ %	**CMR** (CM$ / S)

Notes:

* A contribution margin per unit can be calculated by dividing the total amounts by the number of units. (If there are various types of units, the result is an average amount per unit.)

V Total variable costs and expenses include:

Variable cost of goods sold	$ ______________	
Variable selling expenses	$ ______________	
Variable administrative expenses	$ ______________	
Total variable costs and expenses	$ ______________	**V**

See **Filled-In Form B4** for an illustration.

Learn about break-even point at www.AccountingCoach.com

High-low Method

!!! This form allows you to quickly determine how much of a cost is fixed and how much will vary as volume changes. The high-low calculation will be helpful in calculating some of the amounts needed for determining the break-even point and for forecasting changes in profits.

High-low Method © AccountingCoach.com - **Form B7**

The high-low method is a technique for estimating the variable and fixed cost components of mixed costs. The first step is to determine the approximate variable rate per unit of activity (such as units of output, units of input, miles driven, etc.). The second step is to determine the approximate amount of fixed costs during a time period (year, month, week, etc.).

Calculation of the variable cost rate

If the fixed costs do not change as the levels of activity change, the change in the total costs is assumed to be the change in total variable costs. Therefore, the variable cost rate is the *change in the total costs* divided by the *change in the units of activity*.

Change in total costs:

Total **costs** at the ***high*** level of activity	$	**HC**	
minus Total **costs** at the ***low*** level of activity	$	**LC**	
= Change in total costs	$	**VC**	(HC - LC)

Change in total units of activity:

Total **units** at the ***high*** level of activity		**HU**	
minus Total **units** at the ***low*** level of activity		**LU**	
= Change in total units of activity		**U**	(HU - LU)

Variable cost rate:

Change in total costs	$	**VC**	
divided by the change in total units of activity		**U**	
= Variable cost rate	**$**	**VR**	(VC / U)

Calculation of the total fixed costs

Total costs at the ***high**** level of activity	$	**HC**	
Total **units** at the ***high**** level of activity		**HU**	
Variable cost rate	$	**VR**	(from above)
Total amount of variable costs at high level of activity	$	**HVC**	(HU x VR)
Total amount of fixed costs	**$**	**F**	(HC - HVC)

*The calculation of the total fixed costs can also be computed by using the dollars and units at the low level of activity.

Notes:

VC Variable costs are those costs that change in proportion to a change in activity or volume.

The total costs on an accrual basis must be aligned with the units of activity. For example, the electricity used between the meter reading dates indicated on the utility bill must be aligned with the machine hours occurring between the meter reading dates.

See **Filled-In Form B7** for an illustration.

Cash Flow to Debt Ratio

!!! This form instructs you how to relate a company's cash flow from operations to the company's liabilities. The resulting ratio indicates a company's ability to pay its obligations.

Cash Flow to Debt Ratio

Cash flow to debt ratio = Net cash flows from operating activities divided by the **average total liabilities during the year**

The calculation of **cash flow to debt ratio** includes:

Net cash flows from operating activities from the statement of cash flows for the year ended ______________________.

Average total liabilities computed from the balance sheets during the year.

Net cash flows from operating activities	$ ____________	**OA**	
divided by the *average* amount of liabilities	$ ____________	**AL**	
= Cash flow to debt ratio	____________ **:1**	**CFD**	(OA / AL)

Notes:

OA Net cash flows from operating activities is also referred to as *net cash from operations*. It is the total of the items reported in the first section of the statement of cash flows.

AL The total amount of liabilities is reported at the end of the liability section on the balance sheet. Since the *average* amount of total liabilities during the year is required, you will need to look at the balance sheet amounts throughout the year. If the changes are not significant, you can compute a simple average of the beginning of the year amount and the end of the year amount. If the amount of total assets has changed significantly, **Form G3** can be used to compute a 13-month average.

CFD The cash flow to debt ratio indicates an organization's ability to pay its liabilities from its cash flows from operations.

See **Filled-In Form R24** for an illustration.

Learn more about financial ratios at www.AccountingCoach.com.

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