Welcome to Copernicus CPA Review!

FAR

Copernicus CPA Review

Hey there! This is the version of our memorization guide for CPA candidates who aren't yet actively studying on our platform. It has everything the other version does, and includes two extra slides including this one to let you know why you might want to give Copernicus CPA Review a try.

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FAR Exam Memorization Guide

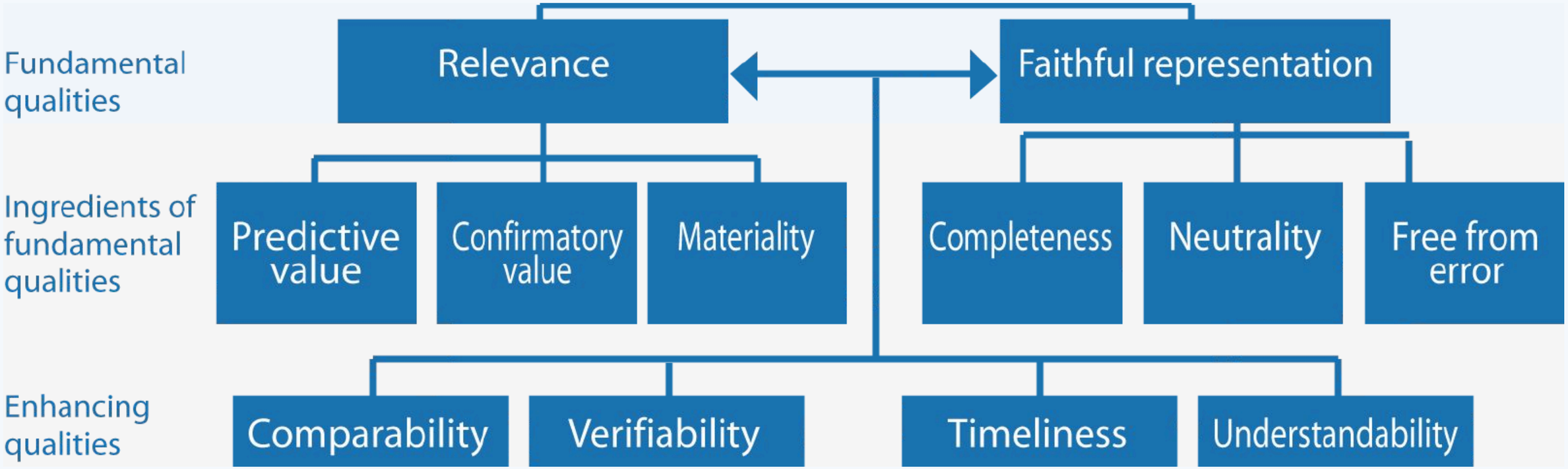
Guide version 5.3.1

This guide reflects the current AICPA Exam Blueprint for FAR, covering selected FAR topics and the foundational accounting concepts needed to apply them. Key standards reflected include ASC 842 (Leases), ASC 606 (Revenue Recognition), ASC 326 (Current Expected Credit Losses, CECL), and ASC 820 (Fair Value Measurement). Governmental accounting content reflects the GASB 34/54 reporting model as amended, and not-for-profit content reflects current ASC 958 guidance. Use the applicable CPA Exam Blueprint and pronouncement testability rules when reviewing this guide. Every page is checked line by line against primary authority before each version is released.

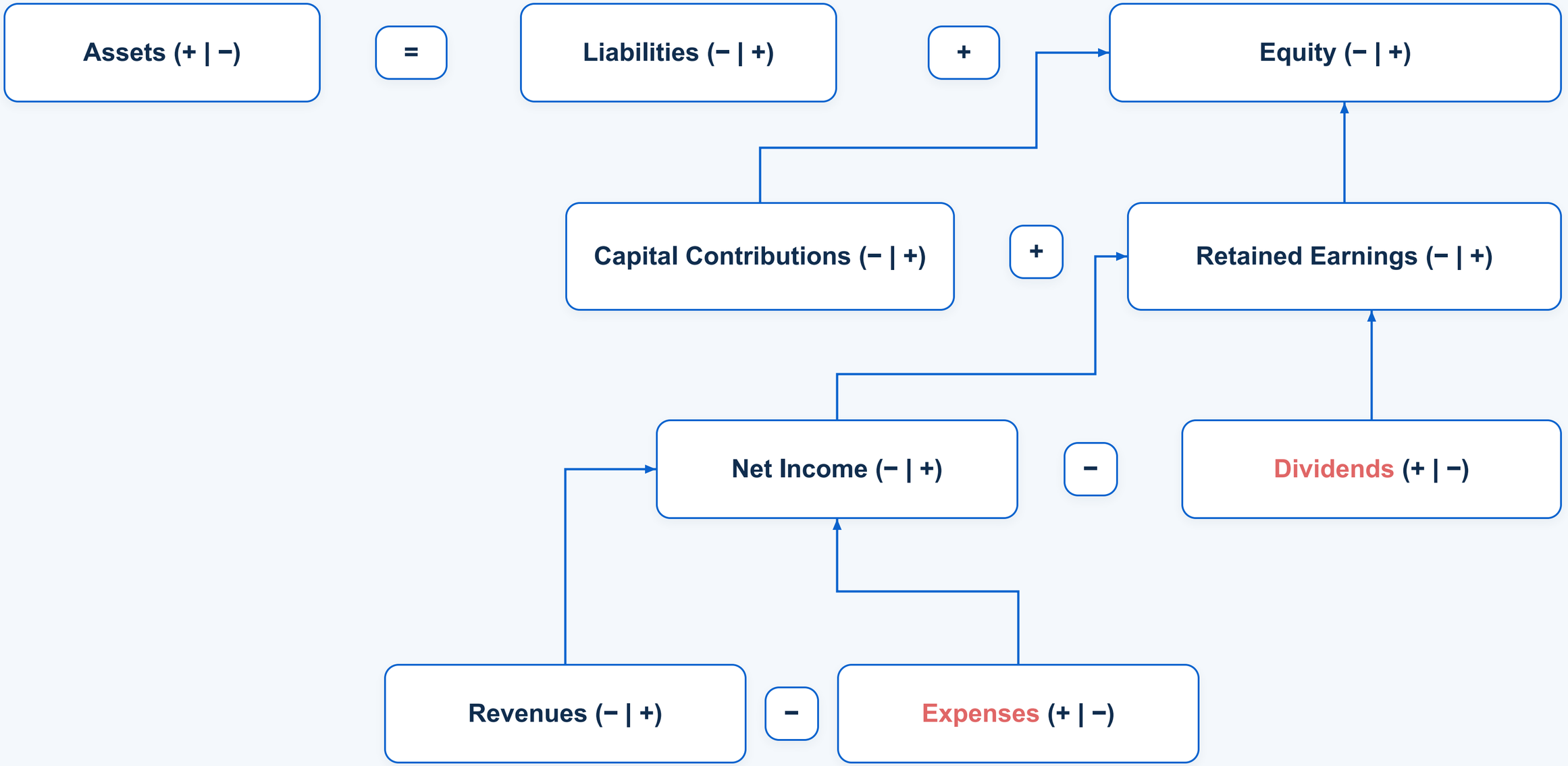
Each of the CPA exams is different. The FAR exam, while not easy, has the benefit of being a memorization-heavy exam. Why is this a benefit? If you were able to take the exam with a textbook, you would likely pass. By memorizing the essentials covered in this guide, your mind becomes a concise FAR textbook that you can bring in on exam day.

When it comes to the formulas, ratios, and content included here, my sincere advice is to not enter the exam until it is all memorized. Do not view this as a cause for concern; rather, view it as a lifesaving guide that will earn you free and stress-free points on the exam. Do the heavy lifting now while you have time, rather than a week before the exam when you would have to cram.

Hierarchy of accounting qualities



The accounting equation (Debit | Credit effects)



The accounting equation & financial statement components

Some questions will require you to rewrite the accounting equation in order to calculate other account balances. Here are common ways to rewrite it.

Other ways to rewrite the accounting equation:

Assets - Liabilities = Equity (Net assets) = Book Value

Assets = Liabilities + Paid-in capital + Retained earnings + Accumulated other comprehensive income - Treasury stock. Ending retained earnings = Beginning retained earnings + Net income - Dividends, adjusted for applicable direct retained-earnings entries.

Balance Sheet	Income Statement
• Assets • Liabilities • Equity • Equity includes paid-in capital, retained earnings, accumulated OCI and treasury stock. Owner investments and distributions are changes in equity.	• Revenues • Expenses • Gains • Losses

Components of comprehensive income

Net Income	+	Other comprehensive income
Revenues		Pension Adjustments
–		Unrealized Gains and Losses (on Available-for-Sale Debt Securities)
Expenses		Foreign currency translation adjustments
		Instrument-specific credit-risk changes for financial liabilities measured using the fair value option.
		Cash Flow Hedges

Present OCI net of related income taxes, or before tax with the related tax amount disclosed.

Cash flow classifications

Cash flows from Operating

- Selling products
- Collecting receivables
- Purchasing inventory
- Paying vendors
- Purchasing supplies
- Paying taxes
- Purchasing or selling securities acquired specifically for resale in trading activities: operating. Otherwise classify by acquisition nature and purpose.
- Collecting interest on an investment
- Collecting dividends on an investment (NFP: if donor-restricted to long-lived assets or endowment, financing)
- Paying interest on debt

Cash flows from Investing

- Selling long-term assets
- Purchasing long-term assets or investments for cash

Cash flow classifications (continued)

Cash flows from Financing

- Borrowing funds through debt
- Paying principal on debt
- Issuing common or preferred stock
- Paying dividends on common or preferred stock
- Repurchasing stock
- Paying debt prepayment or debt extinguishment costs
- NFP: receiving cash gifts restricted to long-lived assets or endowments

The two methods for operating cash flows

Operating Activities: Direct Method	Operating Activities: Indirect Method
1. Cash received from customers. **2. Cash paid to suppliers.** **3. Cash paid to employees.** **4. Interest and dividends received.** **5. Interest paid.** **6. Income taxes paid.** **7. All other cash transactions not accounted for elsewhere.**	1. Start with net income for a business entity or the change in net assets for an NFP. 2. Adjust net income for noncash items such as depreciation and the impairment of goodwill. 3. Reverse gains and losses from investing or financing items (e.g., sale of PP&E, debt extinguishment). 4. Adjust for changes in operating current assets and current liabilities (items related to financing/investing go to those sections): **Current assets increase: subtract** **Current assets decrease: add** **Current liabilities increase: add** **Current liabilities decrease: subtract**
Financing Activities: Direct and Indirect Methods	Investing Activities: Direct and Indirect Methods
1. All sums borrowed and/or repaid (principal amount only). **2. Issuance and/or repurchase of own company stock.** **3. Dividends paid (not received).**	1. All sums lent and/or repaid (principal amount only). 2. Purchase and/or sale of productive assets and investments (including fixed assets, intangible assets, and non-trading investment securities (AFS, HTM)).

Disclosures

The summary of significant accounting policies (within the notes to the FS) includes:

- A basis of measurement for how numbers are used in preparing the financial statements.
- Accounting principles and methods used during the financial statement period.

Examples of Items Included in the Summary of Significant Accounting Policies

Amortization of intangibles
Selected depreciation methods
Basis of consolidation
Criteria for which investments are cash equivalents
Inventory pricing
Use of estimates
Revenue recognition issues such as franchises or leases
Unusual accounting methods

Types of financial information

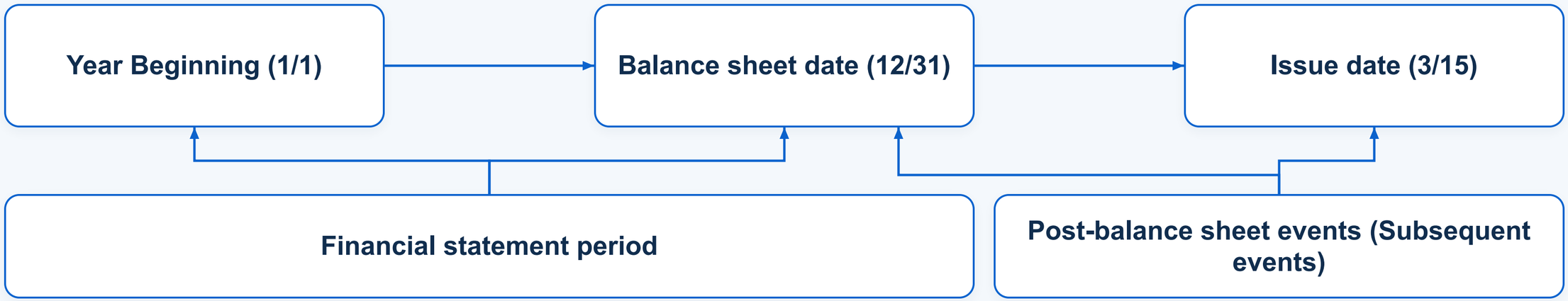
		Basic Financial Statements	Area Directly Affected by Existing FASB Standards	Financial Reporting	All Information Useful for Investors and Creditors
Financial Statements	• Balance Sheet • Income Statement • Statement of Cash Flows • Statement of Equity	✓	✓	✓	✓
Notes to Financial Statements	• Accounting Policies • Contingencies • Inventory Methods • Number of Shares Outstanding	✓	✓	✓	✓

Types of financial information (continued)

		Basic Financial Statements	Area Directly Affected by Existing FASB Standards	Financial Reporting	All Information Useful for Investors and Creditors
Supplementary Information	• Changing Prices Disclosures • Oil and Gas Reserves Information		✓	✓	✓
Other Means of Financial Reporting	• MD&A • Letters to Stockholders			✓	✓
Other Information	• Analysts' Reports • Economic Statistics				✓

Events after the balance sheet date

Evaluate events after the balance sheet date through the date the statements are issued (SEC filers and public conduit bond obligors) or available to be issued (other entities). Recognized events adjust the statements; nonrecognized events are disclosed if material. This will be elaborated on more in the subsequent events section (also seen on the AUD exam).



NFP financial statements & their components

Required FS of NFP Organizations

- Statement of financial position
- Statement of activities
- Statement of cash flows

Net assets with donor restrictions – Part of net assets of a not-for-profit entity subject to donor-imposed restrictions (donors include other types of contributors, including makers of certain grants).

Net assets without donor restrictions – Part of net assets of a not-for-profit entity not subject to donor-imposed restrictions (donors include other types of contributors, including makers of certain grants).

Pledges (Receivables)

- Unconditional promises: no donor-imposed condition. Recognize contribution revenue and a receivable when received, supported by verifiable documentation; collection is not guaranteed. Pledges due in future periods are time-restricted unless meant for current use.
- Conditional promises contain a barrier to entitlement and either a right of return of assets transferred or a right of release from the donor's obligation. Recognize when conditions are substantially met; cash received before then is a refundable advance.

NFP financial statements & their components (continued)

Functional expenses are classified as:

- Major classes of program services, or
- Supporting activities

All NFPs must analyze expenses by nature and function. Natural expenses include salaries, rent, electricity, supplies, interest expense, depreciation, awards and grants, and professional fees.

Services donated as contributions

Contributed services are recognized if they:

- Create or enhance nonfinancial assets, or
- Require specialized skills
- Are provided by individuals possessing those skills
- And would typically be purchased if not donated (last three together)

Classify per the NFP's presentation; not automatically nonoperating.

The following journal entry is used to record contributed services that meet the criteria for recognition:

DR	Expense or asset	$XXXX.XX	
CR	Contributions - without donor restrictions		$XXXX.XX

Educational NFP accounting

Here is the general formula for Tuition Revenue if there are canceled classes to account for:

Assessed tuition and fees − scholarships/tuition waivers (if reductions of revenue) − cancellations and refunds = Net tuition and fees

Educational NFPs report revenue in the appropriate net-asset class when recognized. Expiration of a donor restriction is a separate reclassification between net-asset classes, not new revenue. These include:

- Student tuition and fees
- Government aid, grants, contracts
- Gifts and private grants
- Endowment income
- Revenues of separate enterprises (e.g. food service revenue, dorm hall rental income)

Form 10-K & filers

Form 10-K:

- Must be filed annually by U.S. registered companies (issuers).
- Filing deadline:

  - 60 days after the end of the fiscal year for large accelerated filers
  - 75 days after the end of the fiscal year for accelerated filers
  - 90 days after the end of the fiscal year for all other registrants

- Contains financial disclosures (business description, risk factors, management's discussion and analysis (MD&A), audited financial statements).
- Form 10-Q: quarterly report for each of the first three fiscal quarters (reviewed, not audited, financial statements and MD&A); no 10-Q for the fourth quarter.
- Form 8-K: current report of specified significant events (e.g., change in auditor, completed acquisition), generally due within four business days.

Form 10-K & filers (continued)

Large accelerated filer: public float (non-affiliate common equity) of $700 million+ as of the last business day of the most recently completed second fiscal quarter, plus 12+ months of SEC reporting and one annual report filed.

- Accelerated filer: public float of $75 million or more, but less than $700 million.
- Accelerated filer status is based primarily on public float. Certain smaller reporting companies (SRCs) with annual revenues < $100 million and public float < $700 million are not accelerated filers. SRC status and accelerated-filer status are related but not identical; apply the float and revenue tests per SEC rules.

Weighted average number of common shares outstanding

Shares outstanding at the beginning of the period
+ Shares sold during the period (on a time-weighted basis)
• Shares reacquired during the period (on a time-weighted basis)
+ Stock dividends and stock splits (retroactively adjusted)
• Reverse stock splits (retroactively adjusted)

= Weighted average number of common shares outstanding

Basic and diluted EPS

Basic EPS =	Diluted EPS =
Net Income − Preferred Dividends	**Income available to common shareholders + dividends on dilutive convertible preferred stock** **+ After-tax interest on dilutive convertible debt**
Weighted Average No. of Common Shares Outstanding	Weighted avg. common shares (assuming all dilutive securities are converted to common stock)

Basic EPS Key Points

- Subtract preferred dividends from net income
- Use weighted average shares outstanding
- Stock dividends and splits: retroactively adjust the weighted average for all periods presented
- Only common shares in the denominator, not preferred

Basic and diluted EPS (continued)

Diluted EPS Key Points

- Add back after-tax interest on convertible debt (if-converted method)
- Add shares from assumed conversion of dilutive securities (options, warrants, convertibles)
- Only include if the effect is dilutive (lowers EPS); exclude antidilutive securities
- Use treasury stock method for options/warrants

- For basic EPS, deduct current-period cumulative preferred dividends whether declared or not; deduct noncumulative preferred dividends only when declared. Do not deduct prior-period dividend arrears again.

Cash basis vs accrual basis accounting

Cash Accounting	Accrual Accounting
Record revenue when cash is received	Record revenue when it is earned (when (or as) control of the goods or services transfers to the customer)
Record expenses when cash is spent	Record expenses when they are incurred
Taxed on income when actually or constructively received	Taxed on income even if cash has not been received

Cash basis vs accrual basis accounting (continued)

- Cash to accrual (simple service entity): revenue = cash collected + increase in A/R - increase in deferred revenue.
- Expense = cash paid + increase in accrued liabilities - increase in prepaid expenses.
- Modified cash basis = cash basis plus selected accrual adjustments; label statements by basis.

Bank reconciliation

Company Name, Checking Account# ____ Bank Reconciliation as of _____ (date)

Balance per BANK	Balance per BOOKS
Unadjusted balance from the bank statement (or online bank info) $ xxxx.xx	Unadjusted balance in the company's general ledger Cash account $ xxxx.xx
Adjustments to bank balance:	Adjustments to company's books:
Add: Deposits in transit +	Add: Bank interest earned +
Deduct: Outstanding checks −	Add: Auto / electronic deposits +
Add: Bank errors (understated) +	Deduct: Bank fees charged −
Deduct: Bank errors (overstated) −	Deduct: Check printing cost −
	Deduct: Auto / electronic payments −
	Deduct: Returned checks (NSF) −
	Add: Company errors (understated) +
	Deduct: Company errors (overstated) −
Adjusted balance per Bank $ xxxx.xx	**Adjusted balance per Books $ xxxx.xx**

Cash equivalents: maturity of 3 months or less when the entity acquires them.

BASE formula

B Beginning balance: A/R | Allowance for credit losses

A **Add:** credit sales + recoveries reinstated (A/R) | credit loss expense + recoveries (allowance)

Subtotal

S **Subtract: collections + write-offs (A/R) | write-offs (allowance)**

E **Ending balance:** A/R | Allowance (net A/R = A/R - allowance)

Uncollectible receivables: direct write-off vs allowance (CECL)

Direct Write-Off Method	Allowance Method (CECL, ASC 326)
Immediate recognition of uncollectibles	Periodic recognition of estimated expected credit losses
Expense recorded when an account is written off	Allowance = expected lifetime credit losses on receivables at the reporting date
Accounts are written off when determined non-collectible	Credit loss expense = adjustment needed to reach the required ending allowance; write-offs debit the allowance and credit A/R
Appropriate only if amounts are not material	Must be followed if amounts are material

Direct write-off is not acceptable under GAAP unless the effect is immaterial (it is the tax method).

Estimating the allowance	How it is used
Aging of receivables / Percentage-of-Receivables	Estimation inputs for the required ending allowance (Balance Sheet Approach), using historical loss experience, current conditions and reasonable, supportable forecasts
Percentage-of-Sales	Legacy Income Statement Approach; not the CECL measurement rule

Uncollectible receivables: applying the allowance method (CECL)

- Use the question's facts to set the required ending allowance; the adjustment is credit loss expense.
- Practical expedient (ASU 2025-05) for current AR and contract assets from ASC 606 revenue: an entity may elect to assume conditions at the balance sheet date do not change over the asset's remaining life.
- Labels: allowance for doubtful accounts = allowance for credit losses; bad debt expense = credit loss expense. Treat them as the same accounts.

Recognizing notes receivable (the flip side of bonds!)

- For this example, assume a 10% stated coupon rate.
- The discount or premium is amortized to interest revenue by the effective interest method.

Market Rate/Effective Rate	Issuance
8%	Premium
10%	Face Value
12%	Discount

Disposing of A/R and N/R

Receivables are normally settled by collecting cash from the debtor. Other transactions include pledging receivables as collateral and selling or factoring them. ASC 860 treats each transfer as either:

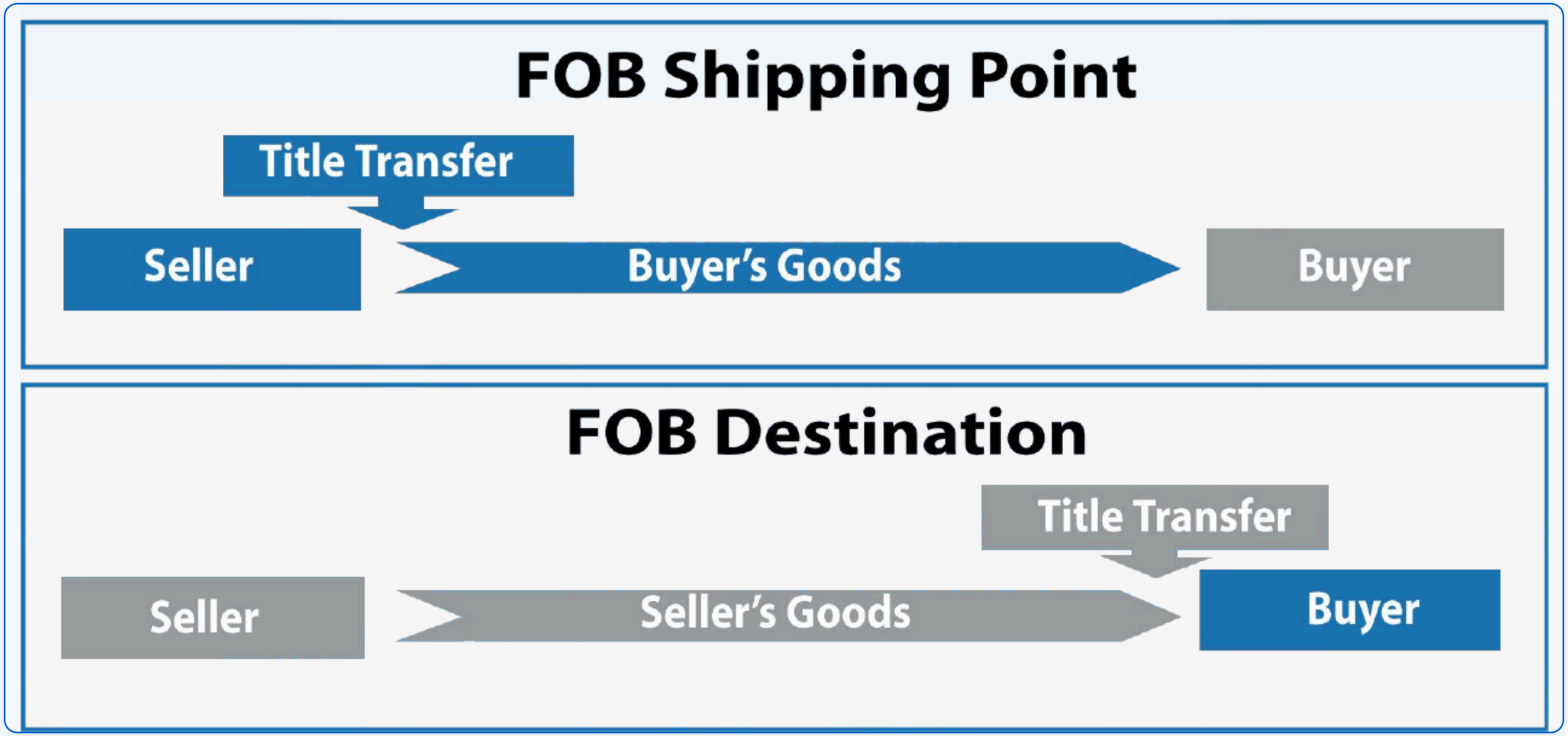
Secured Borrowing	Sale of Receivables
Holder retains ownership of receivables	Holder transfers ownership of receivables
Original company assumes risk of collection	A sale may be with or without recourse. Retaining some collection risk does not automatically prevent sale accounting when the control criteria are satisfied; recognize any recourse obligation incurred.
Transferred assets not isolated from transferor	Transferred assets isolated from transferor
Transferee does not have right to pledge or sell assets	Transferee has right to pledge or sell assets
Transferor has not divested itself of control through repurchase agreement	Sale accounting requires all three conditions: legal isolation from the transferor and its creditors; the transferee's right to pledge or exchange without a constraint that benefits the transferor more than trivially; and no retained effective control. A qualifying repurchase arrangement can retain effective control. If any condition fails, account for the transfer as a secured borrowing, even if the other two conditions are met.

A/R aging schedule

Here is an example of an A/R aging schedule (possible Sim!) using made up balances to arrive at our estimated uncollectible accounts.

Classification by Due Date	Balances in Each Category	Estimated Uncollectible Rate	Estimated Uncollectible Amount
Current	$50,000	0.01	$ 500
31-60 days	40,000	0.025	1,000
61-90 days	15,000	0.10	1,500
Over 90 days	15,000	0.20	3,000
	$120,000		$6,000

- The $6,000 estimate is the required ending allowance, not automatically the current-period expense. If the unadjusted allowance has a $1,000 credit balance, record $5,000 of credit loss expense; if it has a $1,000 debit balance, record $7,000. Net receivables after the allowance are $114,000.


FOB Shipping Point
Title Transfer
Seller
Buyer's Goods
Buyer
FOB Destination
Title Transfer
Seller
Seller's Goods
Buyer

Who has ownership of the inventory? Free On Board (continued)

Goods held on consignment remain in the consignor's inventory until control transfers to an end customer; the consignee excludes them from its own inventory. Physical possession alone does not establish control.

Effects of over and understating inventory

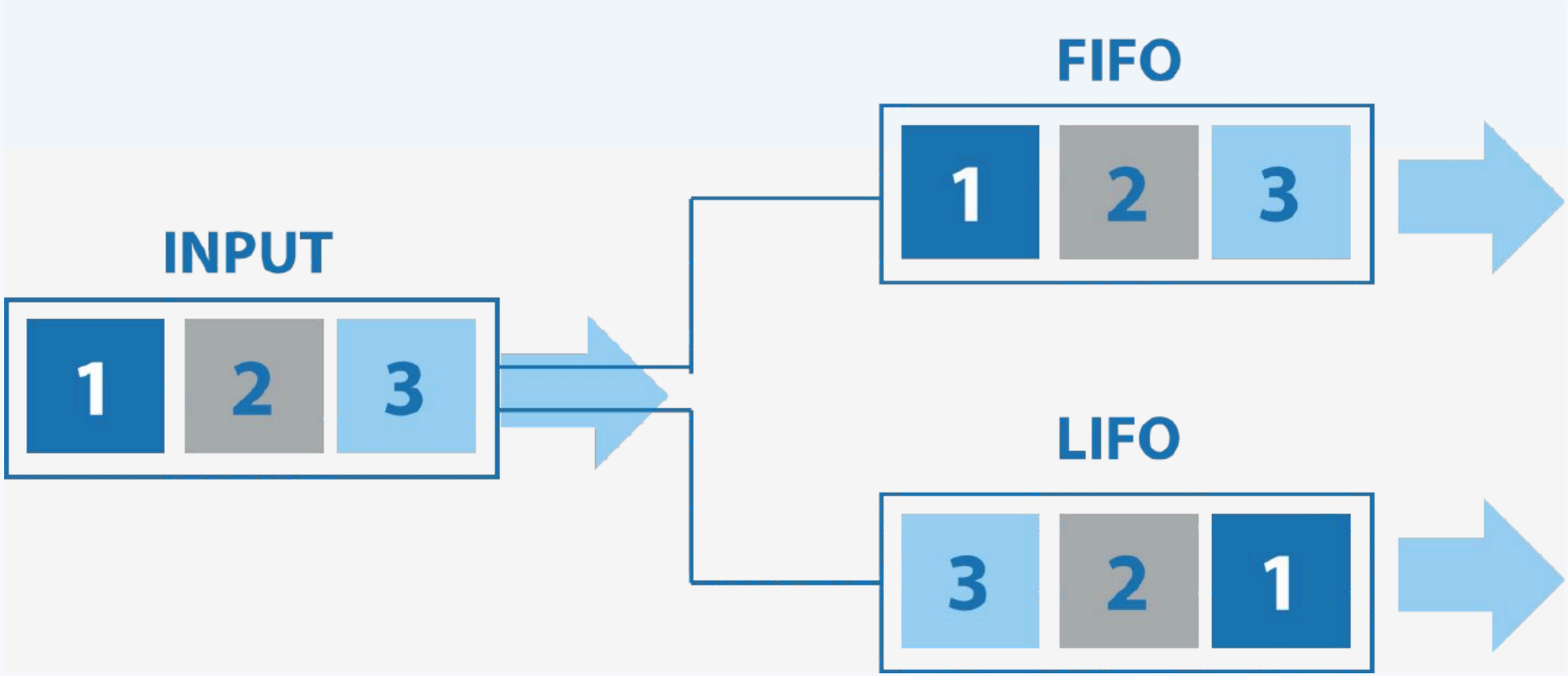
Error in Ending Inventory	Effect on Income Items	Effect on Balance sheet Items
Understated	COGS (over) Net income (under)	Inventory (under) Retained Earnings (under)
Overstated	COGS (under) Net income (over)	Inventory (over) Retained Earnings (over)

Costs included in inventory

Product costs	Period costs
Inventoriable	Not inventoriable
Balance Sheet	Income Statement
Capitalized	Expensed
Normal Spoilage	Abnormal Spoilage

- Inventory cost includes the net purchase cost, normal freight-in and handling, direct labor and allocated manufacturing overhead. Expense selling costs, freight-out, abnormal spoilage and unallocated fixed overhead from abnormally low production. Product costs become cost of goods sold when the related inventory is sold.

LIFO & FIFO



Unit 1 is the oldest. Read each box left to right in the order sold: FIFO sells oldest first, LIFO sells newest first.

Subsequent PP&E expenditures: expense versus capitalize

		Expense (IS)	Capitalize (BS - Asset NBV)	Reduce Acc Dep (BS - Asset NBV)
Additions: Increase quantity			✓	
Improvement / Replacement	Increase life			✓
	Increase usefulness		✓	
Ordinary repair		✓		
Extraordinary repair	Increase life			✓
	Increase usefulness		✓	

- Depreciation: straight-line = (cost - residual value) / useful life; units-of-production = (cost - residual value) x units used / total estimated units; double-declining = beginning book value x 2 / useful life (stop at residual value).
- A change in useful life or residual value is a change in estimate: apply prospectively.

Capitalizing vs expensing

What costs are capitalized as compared to expensed? General rules:

- Any costs necessary to get an asset ready for its intended use
- Costs to acquire, successfully defend or improve an asset, subject to topic-specific rules (start-up, organization, advertising and training costs are expensed).
- Goodwill follows its own rules; it can only be created (and as such capitalized) from business combinations and costs incurred to maintain it are expensed
- R&D costs are expensed as incurred; equipment and facilities with alternative future uses are capitalized, and their depreciation is R&D expense.

Remember that capitalized costs are added to the balance sheet as assets and expensed costs are added to the income statement as expenses. In choosing between an additional asset and an additional expense, the asset is preferable to a company, so there is an incentive to try to capitalize costs, thus the importance of this concept.

These rules apply to inventory, PP&E and intangibles; R&D and software have their own rules.

Computing avoidable interest - steps



Computing avoidable interest - steps (continued)

- Capitalize only while expenditures are made, construction activities are in progress and interest is incurred; stop when the asset is substantially complete and ready for use.
- Rates: the specific construction-loan rate on expenditures up to that loan; the weighted-average rate on other borrowings for any excess.

Exchanges of nonmonetary assets

The basic rule for nonmonetary transactions is that the exchange must be based on:

1. The fair value of the asset given up, or
2. The fair value of the asset received, whichever is more clearly evident.

The rules for gain/loss recognition depend upon whether the nonmonetary exchange has commercial substance.

- If the entity's future cash flows are expected to change significantly as a result of the nonmonetary exchange, the transaction has commercial substance.

- Determine whether the risk, timing, and amount of cash flows arising from the asset received is different from the cash flows associated with the outbound asset, or
- Evaluate whether the entity-specific value of the asset received differs significantly from the asset given up

Exchanges of nonmonetary assets (continued)

Types of Exchange	Accounting for Asset Received	Accounting for gain/loss
Has commercial substance	Recognize at fair value	Recognize gain or loss
Lacks commercial substance **• Also record at carrying amount (no gain, except on boot) if fair value is not reasonably determinable or the exchange is of inventory to facilitate sales to customers.**	Record at carrying amount, adjusted for boot	Losses recognized in full; gains deferred, except boot received (<25%) recognizes gain x boot / (boot + FV of asset received). Boot of 25% or more = monetary exchange at fair value.

PPE dispositions

Asset sold for a gain

Cash $100,000	
A/D $50,000	
	Equipment $130,000
	Gain on Sale $20,000

Asset sold for a loss

Cash $100,000	
A/D $20,000	
Loss on Sale $10,000	
	Equipment $130,000

PPE dispositions (continued)

Asset disposed of at carrying value (CV)

A/D $130,000	
	Equipment $130,000

Asset retired for a loss

A/D $120,000	
Loss on Retirement $10,000	
	Equipment $130,000

PPE dispositions (continued)

- Held-and-used long-lived assets: test recoverability when impairment indicators exist. If carrying amount exceeds expected undiscounted cash flows from use and disposal, recognize the excess of carrying amount over fair value as an impairment loss. Continue depreciation using the revised basis.

- Held for sale (criteria met, sale probable within one year): measure at the lower of carrying amount or fair value less cost to sell; stop depreciation.

Intangibles - impairment and amortization

Life	Characteristics	Amortization
Finite	Useful life is limited	Over useful economic life
Indefinite	No foreseeable limit on useful life (indefinite is not infinite; an uncertain life is still finite).	N/A

Impairment test

Finite-lived (ASC 360-10): 2-step test, only when indicators exist:

- Step 1: recoverability (carrying amount vs. undiscounted cash flows)
- Step 2: measure the loss at fair value
  - If carrying amount > undiscounted cash flows (not recoverable), loss = carrying amount - fair value. No reversals under either test.

Indefinite-lived (ASC 350-30): 1-step test, at least annually (optional qualitative screen):

- Fair value

Analysis of current liabilities

Two ratios often used involving current liabilities are:

Current ratio = Current assets / Current liabilities

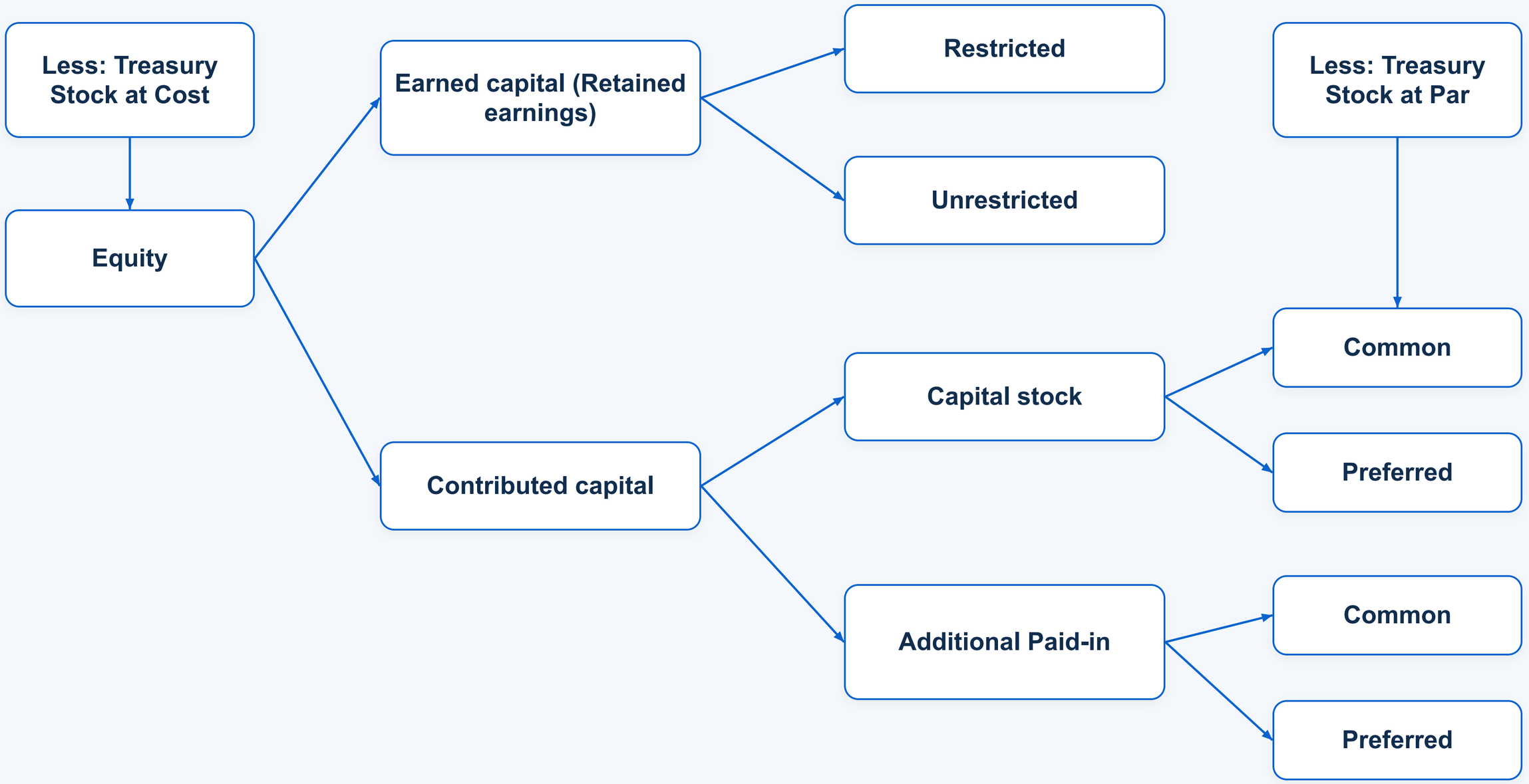
Acid-test ratio = (Cash + Mkt. Sec. + Net Receivables) / Current liabilities

Both are measurements of a firm's liquidity.

- Other ratios: Receivables turnover = Net sales / Average net receivables; Inventory turnover = COGS / Average inventory; Debt-to-equity = Total liabilities / Total equity; Times interest earned = EBIT / Interest expense.

- Return on assets = Net income / Average total assets; Return on equity = Net income / Average equity. Use any formula given in the question.

Equity components



Equity components (continued)

Shareholders' equity accounts	What they represent
Capital stock **Additional paid-in capital**	Contributed capital
Retained earnings	Earned capital
Accumulated other comprehensive income	Other comprehensive income (not yet in net income)

Consolidated: noncontrolling interest is also reported in equity.

Recording treasury stock - two methods

Cost Method

- Treasury stock recorded at the cost paid by the company
- Treasury stock is a contra-stockholders' equity account

Par Value Method

- Treasury stock recorded at par value
- Presented as a deduction from capital stock

Treasury stock at cost method

Purchasing back treasury stock

Treasury Stock (Purchase Cost) xxx	
	Cash xxx

Reissuing treasury stock for cash

Cash xxx	
	Treasury Stock (Purchase Cost) xxx

- Original issue price of stock does not affect subsequent treasury stock transactions.
- No gain/loss recognized when treasury shares reissued.

Treasury stock at cost method (continued)

- The two-account reissue entry shown assumes shares are reissued at their reacquisition cost. Above cost, credit APIC from treasury stock; below cost, debit APIC from treasury stock (prior net gains on treasury sales or retirements of the same class) up to its balance, then retained earnings.

Example - cost method

1/1	Issued 1,000 shares ($100 par) at $110	Cash 110,000 Common Stock 100,000 APIC 10,000
3/1	Reacquired: 100 at $112	Treasury Stock 11,200 Cash 11,200
4/1	10 shares reissued at $112	Cash 1,120 Treasury Stock 1,120

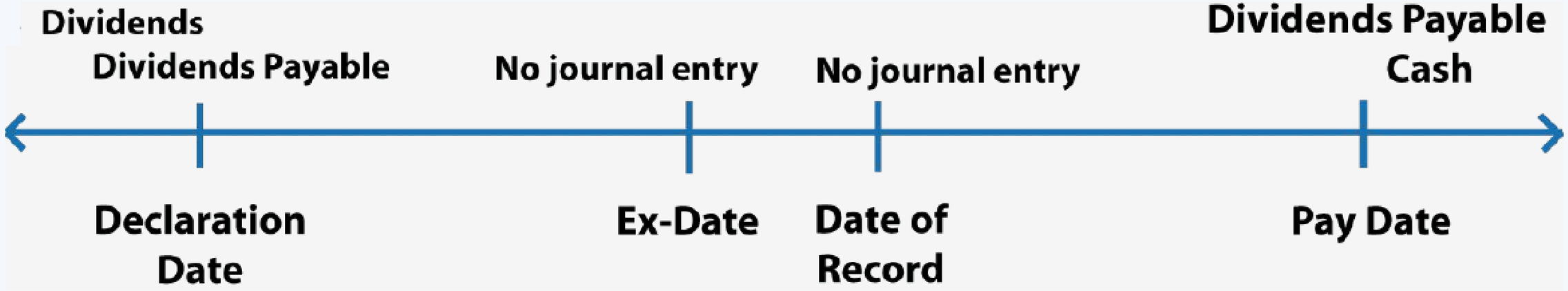
6/1	10 shares reissued at $130	Cash 1,300 Treasury Stock 1,120 APIC-TS 180
8/1	10 shares reissued at $98	Cash 980 APIC-TS 140 Treasury Stock 1,120
10/1	Reissued 10 treasury shares at $105 (cost = $112) Reissuance losses are charged to APIC-Treasury Stock (prior treasury gains, same class) until it reaches $0, then to Retained Earnings; never to income.	Cash 1,050 APIC-TS 40 Retained Earnings 30 Treasury Stock 1,120

Financing methods

Equity	Preferred Stock	Debt
Common Stock	Equity unless mandatorily redeemable (then a liability)	Bonds
Percentage ownership in company	Hybrid of debt and equity	Agreement to borrow money and pay it back later with interest
Dividends paid out are not tax deductible, “double taxation”		Interest expense is tax deductible
Variable cost	Hybrid	Fixed cost
Ownership in company	Equity ownership with preferential rights	Not giving away ownership
Purchased by investors for capital appreciation and dividends	Purchased by investors for fixed income payments rather than capital appreciation	
Ties investor to company risk and reward	Fixed claim: limited share of upside, but still exposed to issuer credit risk.	

Dividend dates to memorize

1. Declaration date (dividends are declared and accrued/accounted for)
2. Ex-dividend date (no entry; under T+1 usually the same day as the record date).
3. Record date (list of stockholders to whom dividends are to be paid is finalized)
4. Payment date (dividends are paid to stockholders of record)



Debit can be to Dividends or Retained Earnings

Stock dividends - small and large

Stock dividends give shareholders stock instead of cash.

	Small Stock Dividends	Large Stock Dividends
Amount issued	Under 20%-25% of stock.	Over 20%-25% of stock.
Accounting	Fair market value of stock issued.	Par value of stock issued.

Small stock dividends transfer fair value from retained earnings to common stock at par and APIC for the excess. Large dividends generally transfer the legally required par or stated amount. Total stockholders' equity is unchanged.

Statement of retained earnings - typical format

B

Beginning Balance:
+/- Prior-period adjustments (net of tax)

= Adjusted beginning balance $

A

Add: Net Income

Subtotal

S

Subtract: Dividends

E

Ending balance: $

Statement of retained earnings - typical format (continued)

- Full statement of changes in equity: one column per component (common/preferred stock, APIC, retained earnings, AOCI, treasury stock), each reconciled from beginning to ending balance.
- Typical items: stock issued, treasury stock bought or reissued, net income, OCI, dividends.

The core principle of revenue recognition (ASC 606)

The guiding principle of modern revenue recognition is: An entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

This core principle can be broken down into two key questions: When? and How much?

When to Recognize Revenue? (Timing)

Revenue is recognized when (or as) the entity satisfies a performance obligation.

A performance obligation is satisfied by transferring control of a good or service to the customer. "Control" means the customer now has the ability to direct the use of, and obtain substantially all the remaining benefits from, the asset.

Think of it like this: Control has transferred when the customer is now in the driver's seat. They can decide how to use the item and prevent others from using it. This is the moment revenue is recognized.

How Much Revenue to Recognize? (Measurement)

The amount of revenue recognized is the transaction price allocated to the satisfied performance obligation.

This is the amount of consideration the company expects to be entitled to receive. This may be different from the price stated in the contract due to factors like discounts, rebates, or performance bonuses (known as variable consideration).

The core principle of revenue recognition (ASC 606) (continued)

- Five steps: identify the customer contract; identify distinct performance obligations; determine the transaction price; allocate that price using relative standalone selling prices; recognize revenue as each obligation is satisfied.
- Estimate variable consideration using expected value or the most likely amount. Include it only to the extent it is probable a significant cumulative revenue reversal will not occur when uncertainty is resolved.

Measuring progress: the cost-to-cost method

For performance obligations satisfied over time, progress can be measured using an input method like the cost-to-cost method. Here are the steps:

1	Costs incurred to date / Most recent estimated total costs = Percent complete
2	Estimated total revenue x Percent complete = Revenue to be recognized to date
3	Total revenue to be recognized to date less revenue recognized in prior periods = Current period revenue
4	Current period revenue less current period costs = Gross profit. Loss on a construction/production-type contract: recognize the entire estimated loss immediately.

Satisfied over time: the three criteria

- Over-time recognition requires one of three conditions: simultaneous customer receipt and consumption; creation or enhancement of a customer-controlled asset; or no alternative use plus an enforceable right to payment for performance to date.

Summary of temporary differences

Transaction	When recorded in books	When recorded on tax return	Deferred tax effect
Revenue or Gain	Earlier	Later	Liability
Revenue or Gain	Later	Earlier	Asset
Expense or Loss	Earlier	Later	Asset
Expense or Loss	Later	Earlier	Liability

Summary of permanent differences

Permanent differences are items (or portions) that appear in either book income OR taxable income, but never both. They create no deferred tax assets or liabilities.

Key rule: There are **no deferred tax effects** for permanent differences. Unlike temporary differences (which create DTAs/DTLs), permanent differences affect the effective tax rate but **never reverse.**

Exam tip: If a question asks you to compute the deferred tax liability or asset, permanently non-deductible expenses (like fines) and permanently non-taxable income (like muni bond interest) are excluded from the calculation entirely. Only temporary differences and loss or credit carryforwards create DTAs and DTLs.

Summary of permanent differences (continued)

Category	In Books?	On Tax Return?	Examples	How to Remember
Non-Taxable Income (Revenue in books, excluded from tax return)	Yes (as revenue)	**Never**	• Municipal bond interest • Life insurance proceeds (key-person policy)	Income earned, but the IRS says "tax-free", so no tax is ever owed on it.
Non-Deductible Expenses (Expense in books, not deductible on tax return)	Yes (as expense)	**Never**	• Penalties and fines • 50% of meals expense • Key-person life insurance premiums	Money spent and expensed on the books, but the IRS says "you can't deduct that", so it's never on the return.
Tax-Only Deductions (Never in books, deductible on tax return)	**Never**	Yes (as deduction)	• Excess percentage depletion (over cost basis)	A tax deduction with no matching book expense: the IRS allows it, but GAAP doesn't recognize it.

Deferred tax assets and liabilities

From a temporary difference (permanent differences create neither):

Tax < F/S = Liability (Pushing tax into the future)

When an originating difference makes taxable income less than GAAP/book income, a deferred tax liability is created. This is because less tax would have been paid in this period than was reported on the financial statements as income tax expense, and it will have to be paid in the future, thus incurring a liability.

From a temporary difference (permanent differences create neither):

Tax > F/S = Asset (Paying tax now)

When an originating difference makes taxable income greater than GAAP/book income, a deferred tax asset is created. This is because more tax would have been paid in this period than was reported on the financial statements as income tax expense, and it will not have to be paid in the future, thus creating an asset.

Deferred tax assets and liabilities (continued)

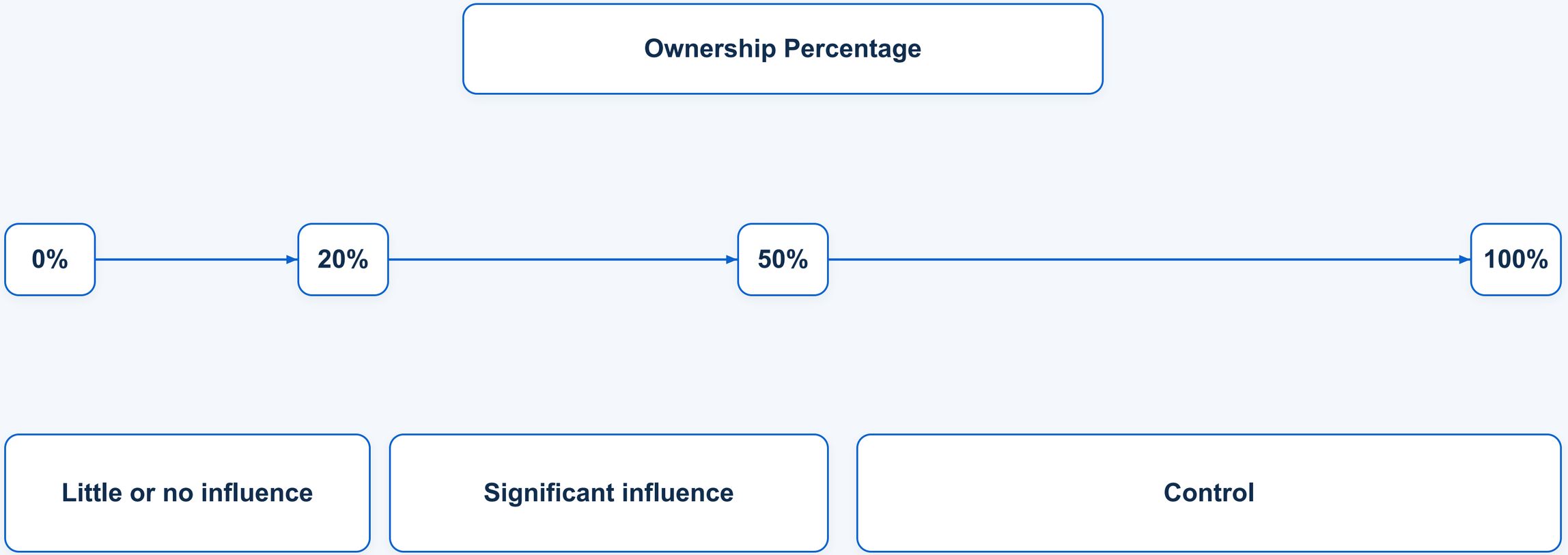
- Measure deferred taxes using enacted rates expected to apply when the temporary differences reverse, without discounting. Reduce a DTA by a valuation allowance when it is more likely than not that some or all will not be realized. Income tax expense combines current and deferred tax expense or benefit.

- Uncertain tax positions: recognize a tax benefit only when its technical merits make survival on examination more likely than not. Assume the taxing authority has full knowledge of relevant facts; the chance of avoiding examination does not establish recognition.

Non-current deferred tax assets/liabilities

Present all deferred tax assets and liabilities as noncurrent. Net DTAs, DTLs and valuation allowance into one noncurrent amount per tax-paying component per jurisdiction; never net across components or jurisdictions.

Equity investments - level of influence



Investments and consolidation

	<20% (presumed no significant influence): FV-NI (ASC 321)	20-50% (presumed significant influence; rebuttable): Equity method (ASC 323)	>50% control: Consolidation (ASC 810)
Investment Account	Remeasured to FV	↑ with share of NI, ↓ for dividends	Eliminated in consolidation (replace with sub assets & liabilities)
Investee Net Income	FV changes → income (no share of NI)	Share of NI increases investment (equity in earnings)	Included line-by-line in consolidated NI (no “investment income”)
Dividends Received	Dividend income	Reduces investment	Eliminated (intercompany) in consolidation

Equity method journal entries

Three main journal entries are used to account for an equity method investment:

Journal entry to record investment at cost (FV of consideration plus legal fees):

DR	Investment in investee	$XXX	
CR	Cash		$XXX

Journal entry to record increase in the investment by the investor’s share of the earnings of the investee:

DR	Investment in investee	$XXX	
CR	Equity in earnings		$XXX

Equity in earnings is reported as income on the income statement.

Equity method journal entries (continued)

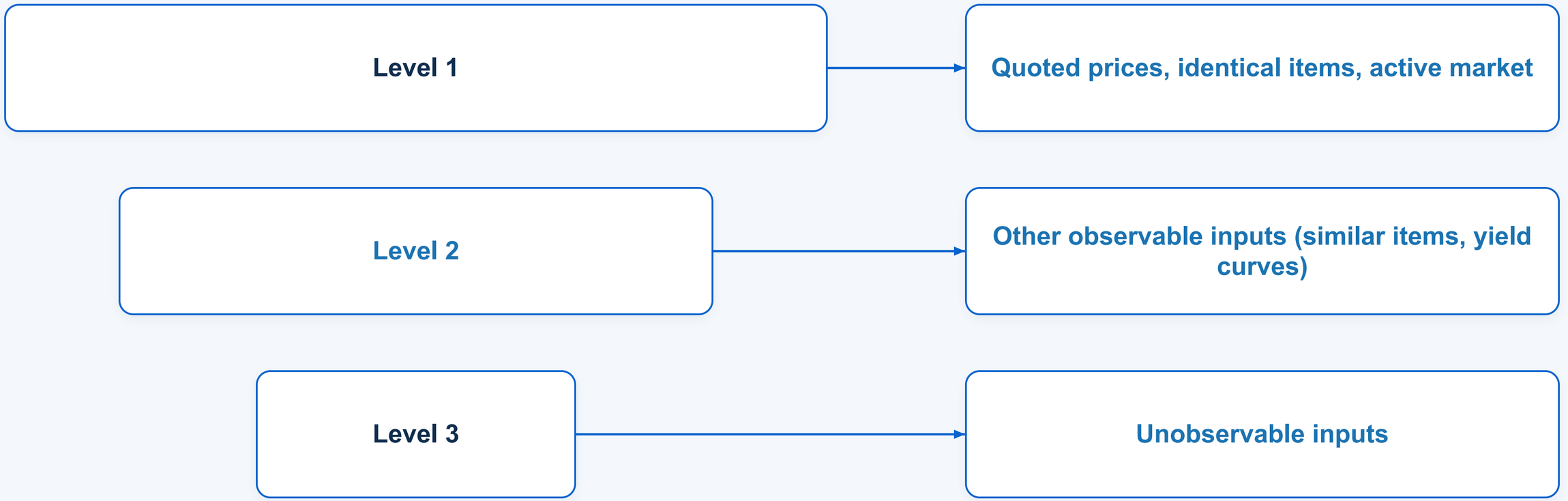
Journal entry to record decrease in the investment by the investor’s share of the cash dividends from the investee:

DR	Cash	$XXX	
CR	Investment in investee		$XXX

- If cost exceeds the investor's share of investee book value, amortize the excess assigned to depreciable or finite-lived assets: DR Equity in earnings, CR Investment in investee (no amortization of goodwill or land).

Fair value hierarchy

Level = lowest level of any significant input



Fair value hierarchy (continued)

- Valuation approaches: market, income (e.g., discounted cash flows) and cost. Use market-participant assumptions; value nonfinancial assets at their highest and best use.
- Debt securities: trading = FV through NI; available-for-sale = FV through OCI (credit losses through NI via an allowance); held-to-maturity = amortized cost (positive intent and ability to hold), with an expected credit loss allowance.
- Equity securities: FV through NI (measurement alternative if no readily determinable FV).

Bond terminology

Bonds Payable: These are the most common type of long-term liability.

Bond Indenture: This is the legal contract that describes the agreement between the bond issuer and holder.

Face Value: This is the “clean number” and the total dollar amount of the bond and the principal upon which interest payments are made. When the stated rate equals the market rate, bonds are issued at face value.

Stated Interest Rate: Rate assigned to bond by issuer which determines interest payments (coupon rate).

Market Interest Rate: This is the rate of interest earned by the bondholder and rate of return for comparable contracts on the date bonds are issued.

Discount: Amount of value less than the face value that a bond is issued at when the market rate is higher than the stated rate. The bonds sell for less than face amount to make up for lower return provided.

Premium: Amount of value more than the face value that a bond is issued at when the market rate is lower than the stated rate. The bonds sell for more than face amount to give more cash to the issuer due to the higher return provided.

- Modification vs extinguishment: if the PV of the new cash flows (at the original effective rate, including creditor fees) differs from the old by 10% or more, treat as an extinguishment (gain or loss); otherwise adjust the effective rate prospectively.

- Covenants: calculate ratios as the debt agreement defines them; a violation can make the debt callable and current unless the creditor waives the right to demand repayment for more than one year from the balance sheet date.

Bond terminology (continued)

- For recognized debt measured at amortized cost, carrying amount = face value plus unamortized premium, less unamortized discount and applicable issuance costs. Present issuance costs as a direct deduction from the related debt and amortize them to interest expense. Initial bond price equals the present value of coupons plus principal using the issue-date market yield.

Bond interest rate terminology

Stated/coupon/nominal rate (Cash)	Market rate/effective yield (IS)
Rate written in terms of bond indenture	Rate providing an acceptable return commensurate with issuer’s risk
Bond issuer sets this rate	Rate of interest earned by bondholders
Determines Interest Payments	Determines PV factor
Cash interest paid/payable (What interest is)	Interest Expense (What interest should be)
FV x coupon rate	CV x market rate/yield

Bond interest rate formulas

Cash Interest Paid/Payable	Interest Expense (IS)
How do you calculate the amount of interest that is actually paid to the bondholder each period?	How do you calculate the amount of interest that is actually recorded as interest expense by the issuer of the bonds?
(Stated Rate x Face Value of the Bond)	(Market Rate x Carrying Value of the Bond)
Difference vs interest expense = discount/premium amortization	What interest should be
Determines interest payments	Determines present value factor

Introduction to premiums and discounts

Assume Stated Rate of 10%

Market Rate	Bonds Sold At
6%	Premium
10%	Par Value
12%	Discount

Accounting changes chart

Type of Change	Description	Examples
Change in Accounting Principle	**Replaces one GAAP with another GAAP**	Adoption of a new FASB standard. Changing inventory cost method (LIFO, FIFO, and WA)
Change in Accounting Estimate	**Revision of an estimate because of new information or new experience**	Switching depreciation methods (SL, DDB, etc.). • A change in depreciation method is a change in estimate effected by a change in accounting principle: apply prospectively, and the new method must be preferable. Estimate change of useful life of depreciable asset. Estimate change of residual value of depreciable asset. Estimate change of bad debt %. Change actuarial estimates pertaining to a pension plan.
Change in Reporting Entity	**Statements become those of a different reporting entity**	Change the subsidiaries included in the consolidated group (a new acquisition is a business combination, not a reporting-entity change). Report consolidated financial statements in place of individual statements.

Changes in accounting principle

Voluntary change: retrospective (unless impracticable). New ASU: follow its own transition provisions.

a. Changing the financial statements of all prior periods presented.

b. Disclosing in the year of the change the effect on net income and EPS for the current and all prior periods presented.

c. Reporting an adjustment to the beginning retained earnings balance in the retained earnings statement in the earliest year presented.

d. Disclosing the nature of and reason for the change, why the new principle is preferable, and how it was applied.

If the cumulative effect cannot be determined (e.g., change to LIFO): apply prospectively. If only period-specific effects are impracticable: adjust opening balances of the earliest practicable period.

For a prospective change to LIFO:

a. Do not change prior years' income.

b. Use opening inventory in the year the method is adopted as the base-year inventory for all subsequent LIFO computations.

c. Disclose the effect of the change on the current year, why retrospective application is impracticable, and how the change was applied.

Summary of accounting changes and correction of errors (continued)

Changes in accounting estimate

Employ the current and prospective approach by:

a. Reporting current and future financial statements on the new basis.

b. Presenting prior period financial statements as previously reported.

c. Making no adjustments to current-period opening balances for the effects in prior periods.

Changes in reporting entity

Employ the retrospective approach by:

a. Restating the financial statements of all prior periods presented.

b. Disclosing in the year of change the nature of and reason for the change and its effect on income from continuing operations, net income, OCI and EPS for all periods presented.

Changes due to error

Employ the restatement approach by:

a. Correcting all prior period statements presented.

b. Restating the beginning balance of retained earnings for the first period presented when the error effects occur in a period prior to the first period presented.

Voting interest model - control of over 50% ownership

0%	20%	50%	100%
Fair Value	Equity	Acquisition method Consolidate	
Do not consolidate		Externally: Consolidate (required). Parent's own books may use the equity or cost method; eliminated in consolidation.	

Controlling Interest: Over 50% of voting shares usually gives control (exceptions: bankruptcy, reorganization, severe foreign controls; VIEs: primary-beneficiary test).

Noncontrolling Interest (NCI): NCI is the portion of the subsidiary's equity (net assets) not attributable to the parent (so less than 50%, however in questions usually ranges from 15% to 30%). NCI is measured at fair value at acquisition, then carried at that amount plus its share of sub income and OCI, less dividends; shown in equity, separate from parent equity.

Subsidiary's value breakdown

Sub's Total (100%) Fair Value

Goodwill

Identifiable intangible assets FV

Balance sheet FV adjustment

Book value (CV)

NCI

Investment in subsidiary (acquisition price)

Noncontrolling interest (NCI)

Questions that have the parent company purchase 100% ownership of a subsidiary will be more simple than those which have the parent purchase, let's say, 70%. This 30% held by other owners does not control the subsidiary, thus the name "noncontrolling interest". This portion of the subsidiary's equity (net assets) is attributed to noncontrolling shareholders and measured at acquisition-date fair value and then carried at that amount adjusted for its share of income, OCI and dividends on the parent's consolidated balance sheet separately from the parent's equity. This may also include the NCI's interest in goodwill in the subsidiary.

Intercompany transactions - balance sheet

All intercompany transactions must be eliminated when consolidating financial statements, including when the subsidiary is not 100% owned by the parent. The financial statements are meant to report information on transactions that occurred. However, many intercompany transactions are not real transactions. The assets and liabilities are still controlled by the same relationship of entities. In these commonly used eliminating journal entries, we eliminate 100% of all intercompany payables and receivables.

DR	Accounts payable	$XXX	
CR	Accounts receivable		$XXX

DR	Bonds payable (intercompany; plug = gain/loss)	$XXX	
CR	Bonds investment (in affiliate)		$XXX

DR	Accrued bond interest payable	$XXX	
CR	Accrued bond interest receivable		$XXX

DR	Dividends payable (affiliate portion only)	$XXX	
CR	Dividends receivable (from affiliate)		$XXX

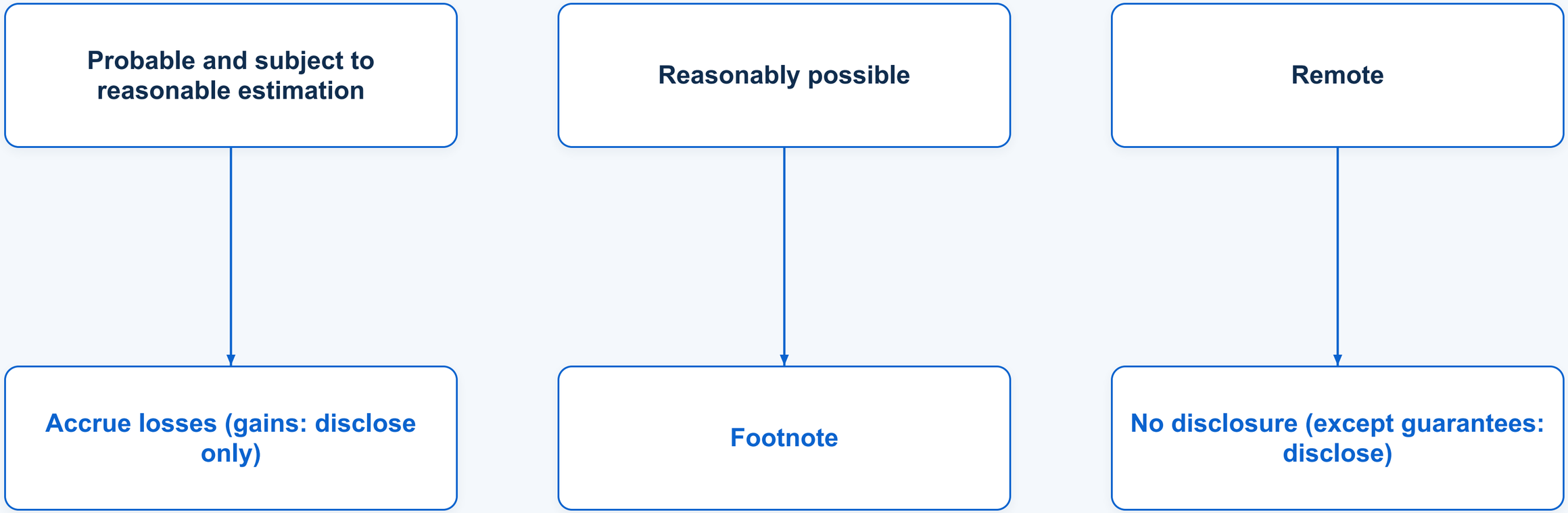
Intercompany elimination example

Many times, parents and subsidiaries will sell inventory to each other for a profit. As such, these intercompany sales and COGS must be eliminated before preparing the consolidated financial statements. These aren't real sales. On the flip side, all unrealized intercompany profit should be eliminated from ending inventory and cost of goods sold of the purchasing affiliate. 100% of profit should be eliminated even if the parent's ownership interest is less than 100% since it is all intercompany, between the parent and sub. Intercompany profit in beginning inventory that was recognized by the selling affiliate in the prior year must be eliminated by an adjustment (debit) to retained earnings.

Workpaper Elimination: Intercompany Merchandise Transactions

DR	Sales (intercompany sales)	$XXX	
DR	Retained earnings (beginning profit)	XXX	
CR	COGS (sales + beginning profit - ending profit)		$XXX
CR	Inventory (ending profit)		XXX

Contingencies & commitments - treatment



Contingency treatments

		Disclosure		
Contingency Treatments	**Accrue Amounts**	**Amount**	**Nature**	**Ignore**
Loss contingency that is probable and: **Amount or range can be reasonably estimated**	(best estimate; minimum if no amount in range is better)	range	✓	
Amount or range cannot be reasonably estimated			✓	
Loss contingency that is a reasonable possibility		range	✓	
Loss contingency that is remote, but is a guarantee of indebtedness of others (ASC 460: also record stand-ready liability at inception)		✓	✓	

Contingency treatments (continued)

		Disclosure		
Contingency Treatments	**Accrue Amounts**	**Amount**	**Nature**	**Ignore**
Gain contingencies that are probable or reasonably possible		✓	✓	
Loss contingency that is remote				✓
Gain contingencies that are remote				✓

If no estimate can be made, disclose that fact instead of an amount.

Terminology

Derivative instrument: financial instrument or other contract whose value changes with an underlying, and has:

- 1+ underlying and 1+ notional amounts or payment provisions (or both);
- No initial net investment required or one that is smaller than ones for similar contracts; and
- Terms require/permit a net settlement (i.e., settled for cash in lieu of physical delivery), or readily settled net outside the contract (e.g., on exchange), or delivery of an asset giving the same results (e.g., asset convertible to cash).

Underlying: specified price, rate, other variable (e.g., interest rate, commodity price), including scheduled event (e.g., payment under contract) that may/may not occur.

Value or settlement amount: amount determined by arithmetic interaction of the notional amount and the underlying (e.g. shares of stock x price per share).

Payment provision: Fixed or determinable settlement made if the underlying behaves in a specified way.

Hedging: use of a derivative to offset anticipated losses or reduce earnings volatility. When effective, change in value of the derivative offsets change in value of a hedged item or the cash flows of the hedged item.

Hedge accounting (ASC 815, as amended by ASU 2017-12)

Under ASC 815 (as amended by ASU 2017-12), hedge ineffectiveness is not separately measured or recognized for cash flow hedges and net investment hedges. The change in fair value of the hedging instrument included in the effectiveness assessment is recorded consistently; no effective/ineffective split; excluded components follow separate rules.

Type of Hedge	Where Changes in Fair Value Are Recorded
No hedge designation	Included in current earnings (net income).
Fair value hedge	Included in current earnings, in the same income statement line item as the hedged item.
Cash flow hedge	Change in fair value included in the effectiveness assessment recorded in OCI. Reclassified to earnings when the hedged transaction affects earnings. Presented in the same income statement line item as the hedged item.
Net investment hedge	Included in OCI as part of the cumulative translation adjustment (CTA).

Hedge accounting (ASC 815, as amended by ASU 2017-12) (continued)

Excluded components (e.g., time value of options, forward points): An entity may elect to record changes in excluded components either (1) currently in earnings, or (2) amortize the excluded component's initial value to earnings on a systematic and rational basis over the hedge's life and record the remaining fair value change in OCI.

Fair Value Hedge → Net Income

Cash Flow Hedge → OCI

Net Investment Hedge → OCI (CTA)

Terminology

- Exchange Rate: rate at which two currencies will be exchanged at equal value. May be expressed as:

  - Direct Method: domestic price of one unit of another currency (e.g. 1 euro costs $1.47 USD).
  - Indirect Method: foreign price of one unit of the domestic currency (e.g. 0.68 euro buys $1.00 USD).

Terminology (continued)

- Current Exchange Rate (record transactions; remeasure monetary receivables and payables at balance sheet date and settlement): exchange rate at the current date, or for immediate delivery of currency (AKA spot rate).
- Transactions: record at the spot rate on the transaction date; remeasure foreign-currency receivables and payables at each balance sheet date and at settlement; the difference is a gain or loss in net income.
- Foreign currency strengthens: receivable = gain, payable = loss (weakens: the reverse).
- Forward Exchange Rate: exchange rate now for exchanging two currencies at a future date.
- Historical Exchange Rate (Use for equity; when remeasuring, also nonmonetary items): rate in effect at the date of issuance of stock or acquisition of assets.
- Weighted Average Rate (Use for IS accounts): calculated to take into account the exchange rate fluctuations for the period. The average rate approximates the rates in effect when items were recognized.

Translation vs remeasurement

Translation (current rate method) is a process to convert the foreign entity's functional-currency statements into the reporting currency.

Remeasurement (temporal method) on the other hand, is the process to convert financial results in another currency into the company's functional currency.

Translation vs remeasurement (continued)

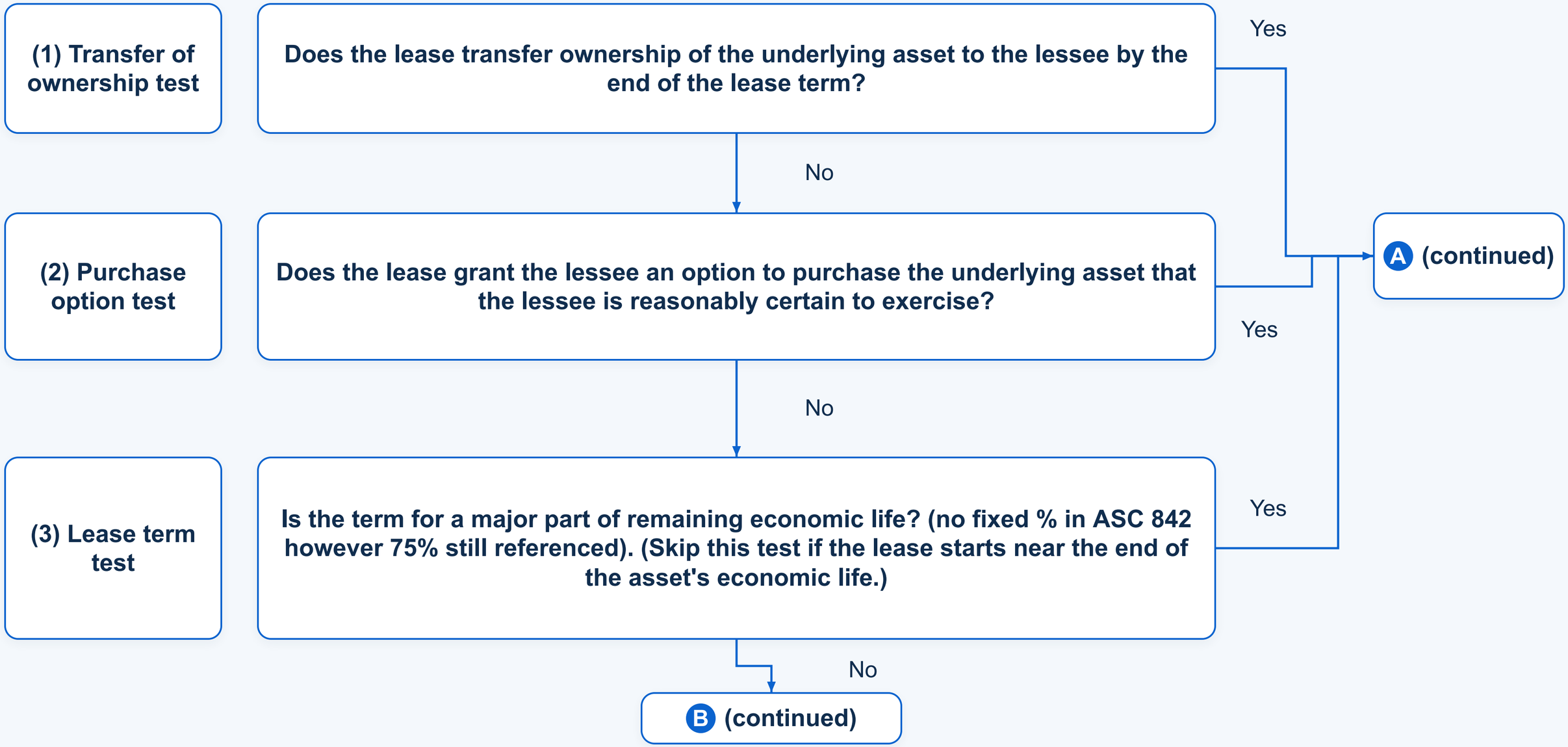
	Translation	Remeasurement
Step 1	Income statement • At weighted average	Balance sheet • Monetary at year-end rate • Nonmonetary at historical (nonmonetary items carried at fair value: rate at measurement date)
Step 2	Balance sheet • At year-end rate • Stock and APIC at historical • Roll forward retained earnings	Income statement • At weighted average • Historical for balance sheet related accounts
Plug	Equity • Accumulated other comprehensive income • Cumulative Translation Adjustment	• Gain/loss so net income is at amount necessary for retained earnings plug
Gain/Loss	**OCI**	**Net income**

Note key differences in order of steps and conversion rates.

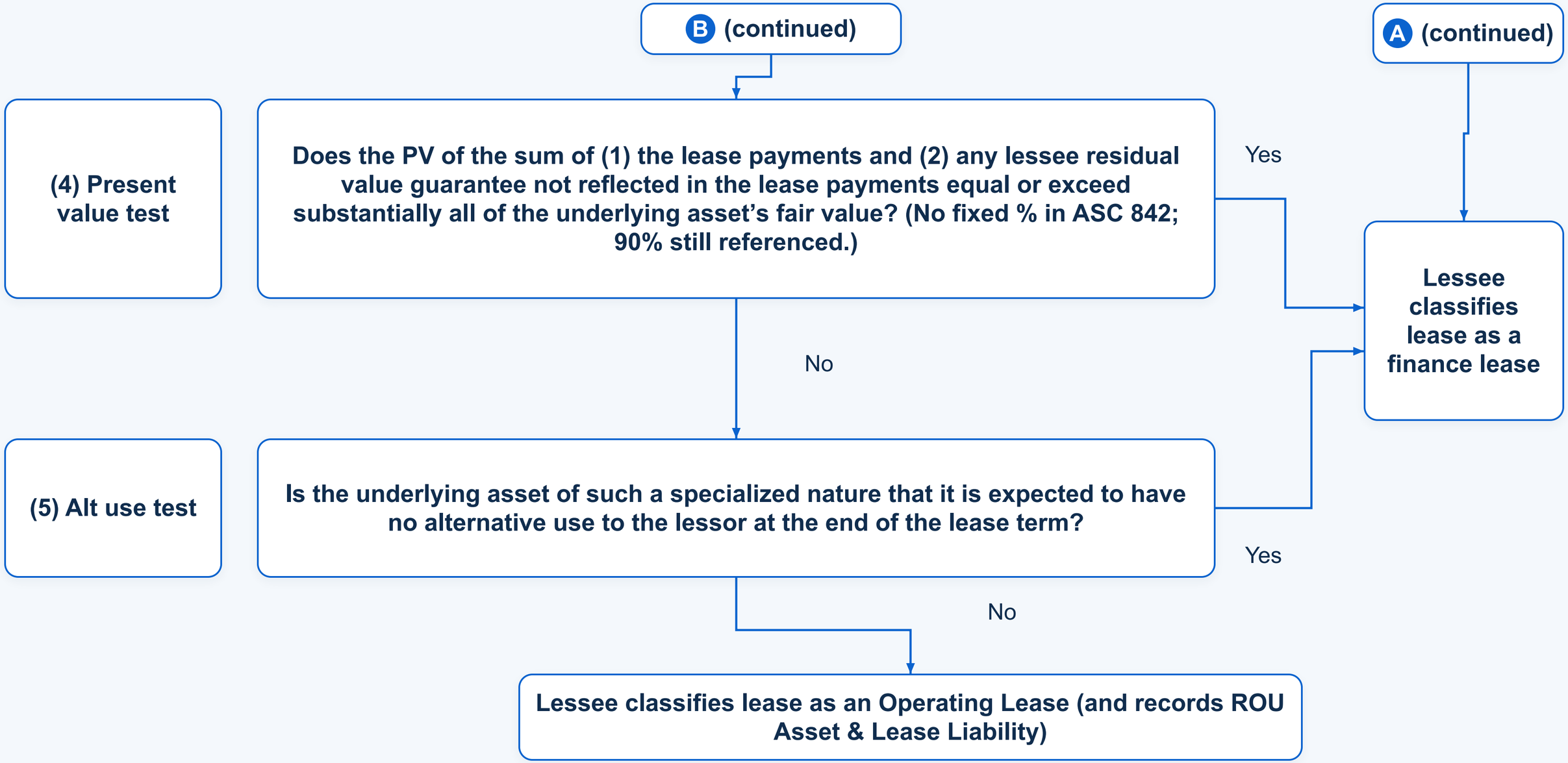
Core Principle of ASC 842: All leases (both finance and operating) with a term > 12 months must be recorded on the Balance Sheet by the lessee. Leases of 12 months or less with no reasonably certain purchase option may be kept off the balance sheet by policy election (by asset class). The lessee records a **Right-of-Use (ROU) Asset** and a **Lease Liability**. The 5 tests on the next pages are used only to classify the lease, which determines the expense pattern on the Income Statement.

- Initial measurement: Lease Liability = PV of unpaid lease payments; ROU Asset = Lease Liability + prepaid lease payments + initial direct costs - lease incentives received.
- Discount rate: the implicit rate if readily determinable, otherwise the incremental borrowing rate (non-public entities may elect a risk-free rate by asset class).
- Lease payments include: fixed payments (less incentives), index- or rate-based payments at the commencement rate, purchase options reasonably certain to be exercised, expected termination penalties, and amounts probable of being owed under residual value guarantees.
- Variable payments based on usage or performance are excluded and expensed as incurred.

Lease classification process - is this just a financing agreement?



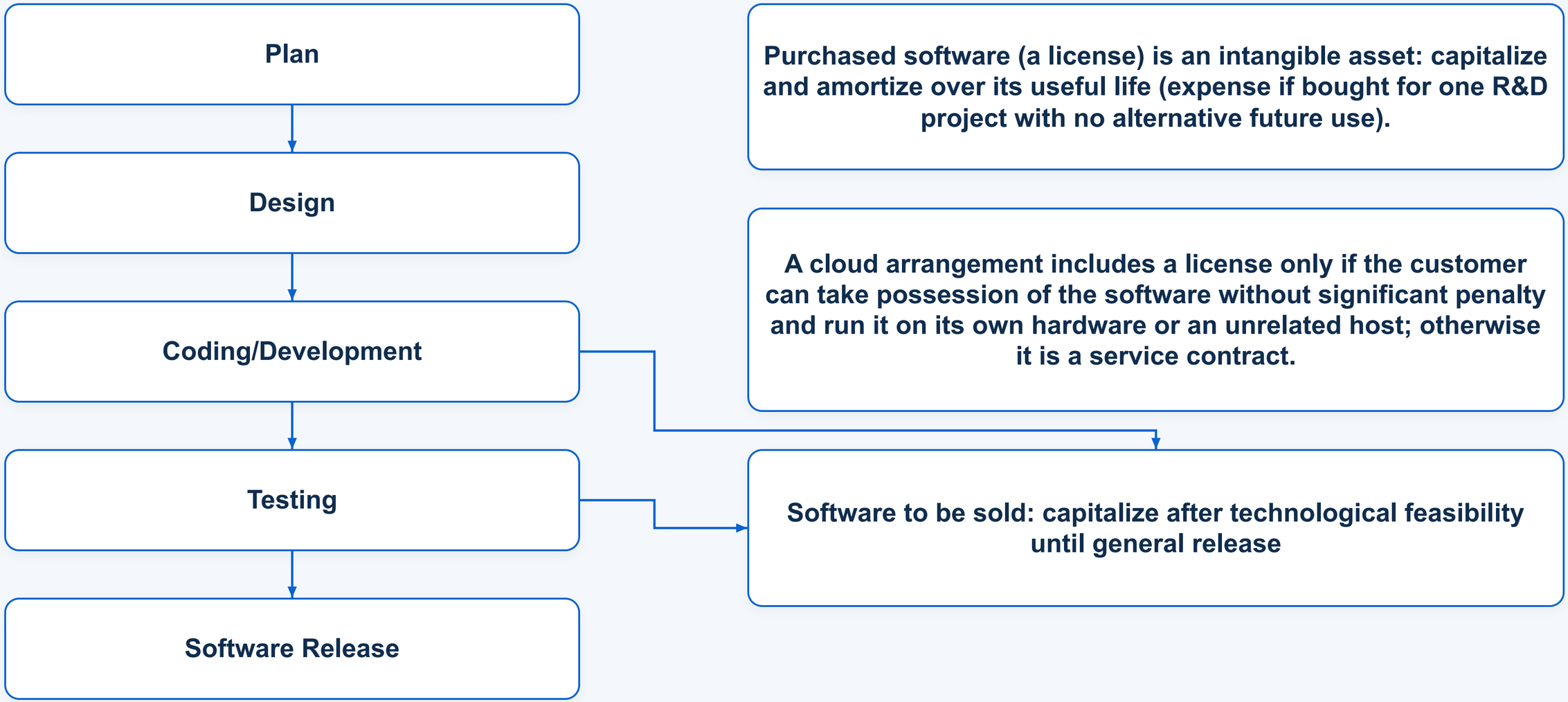
Lease classification process - is this just a financing agreement? (continued)



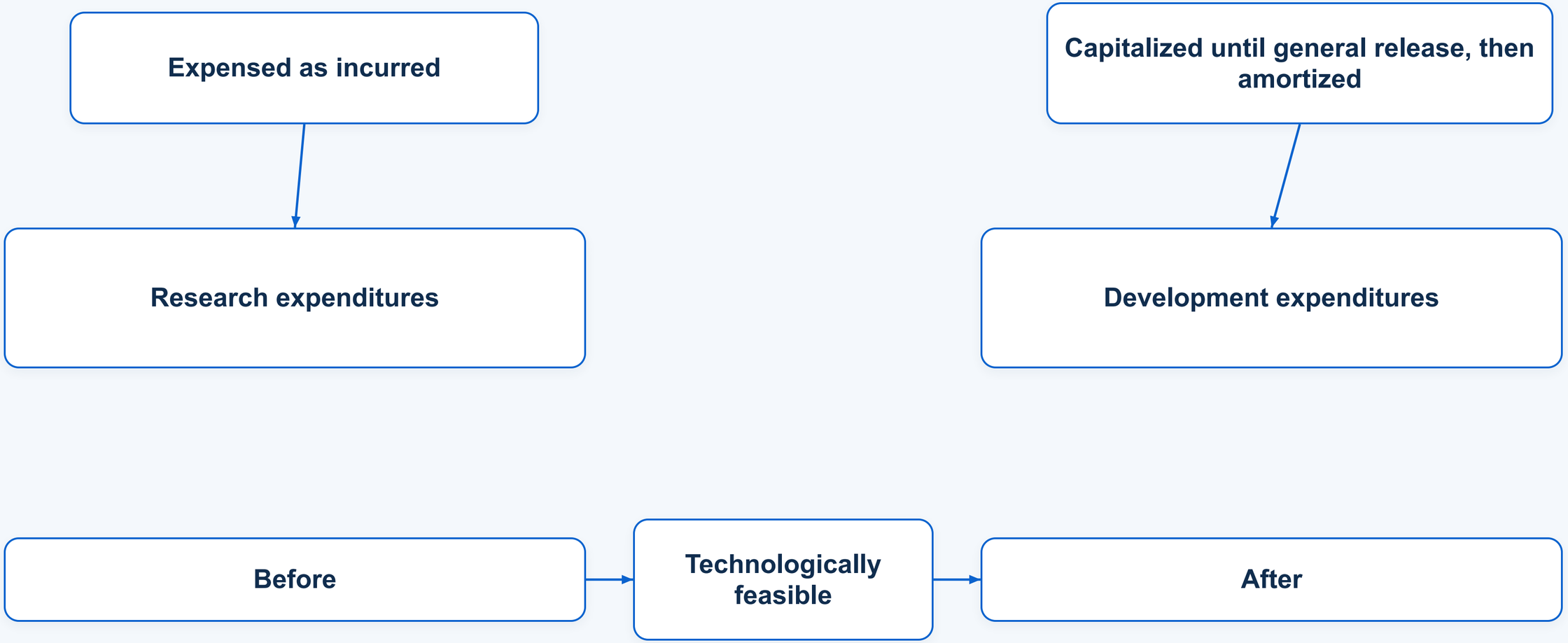
Classification examples

Example	Classification
Cost of conceptual formulation of possible product alternatives	R&D expense
Cost of purchasing a copyright	Intangible
Design, construction and testing of pre-production prototypes and models	R&D expense
Equipment with alternative future uses (other R&D projects or otherwise)	Capitalize; depreciation while used in R&D is R&D expense
Cost of developing a trademark	Expense
Cost of purchasing a trademark	Intangible

Software costs



Software costs (continued)



Software costs (continued)

Previous page applies to “Software to be Sold, Leased, or Marketed” (ASC 985-20).

Internal-use software (ASC 350-40): Expense "Preliminary Project" costs, Capitalize "Application Development" costs (but expense training and data conversion), Expense "Post-Implementation" costs (capitalize enhancements adding functionality).

Software costs (continued)

- Cloud service contract: capitalize implementation costs that qualify under the internal-use rules above; amortize them (generally straight-line) over the hosting term, including reasonably certain renewals, once ready for use.
- Present them like the hosting fees: asset with prepaid hosting, expense with hosting expense, cash payments with hosting-fee payments (operating).

Subsequent events: definition & treatments

A subsequent event is an event that occurs after the balance sheet date and before statements are issued (SEC filers and public conduit bond obligors) or available to be issued (all others).

- When are the financial statements considered issued or available to be issued?
- Issued: widely distributed to users in GAAP form.
- Available to be issued: complete in GAAP form with all approvals obtained.

There are two treatments for these events (in addition to doing nothing if the event is immaterial or not really a subsequent event). These are to:

- Condition existed at the balance sheet date: adjust the statements.
- Condition arose after: disclose only, if material.

Non-recognized subsequent events

Disclose (only)

Subsequent events that you do not recognize still can occur after the balance sheet date but before the date financial statements are issued. A company should not recognize subsequent events for occurrences that do not affect the financial statement period. Keep in mind the reporting constraints. These should be disclosed only if material to the financial statement users.

Examples:

- **Change in equity structure**
- **Acquisition or merger with another company**
- **Settling litigation, however this litigation happened after year end so does not affect the period**
- **Warehouse burning down (common example on the exam)**
- Fair value changes to assets or liabilities
- New significant business commitments or liabilities (issuing significant debt)
- Receivable loss from an event after year-end (e.g., customer's post-year-end fire)

These events are disclosed to give the users a proper understanding of the financial statements. As such, disclose the nature of the event and either an estimate of its financial effect or a statement that it cannot be estimated.

Inventory valuation: LCNRV and LCM

Inventory is written down when its value falls below cost; the test used depends on how the company costs its inventory.

The Primary Rule: Lower of Cost or Net Realizable Value (LCNRV)

This method applies to inventory under any method except LIFO or retail (e.g., FIFO, weighted-average).

- **Step 1:** Determine the inventory's Cost.
- **Step 2:** Determine the Net Realizable Value (NRV).

- NRV = Estimated selling price in the ordinary course of business - reasonably predictable costs of completion, disposal, and transportation.

- **Step 3:** Compare the Cost (Step 1) to the NRV (Step 2). The lower of the two values is the amount reported on the balance sheet.

Inventory valuation: LCNRV and LCM (continued)

The Exception: Lower of Cost or Market (LCM)

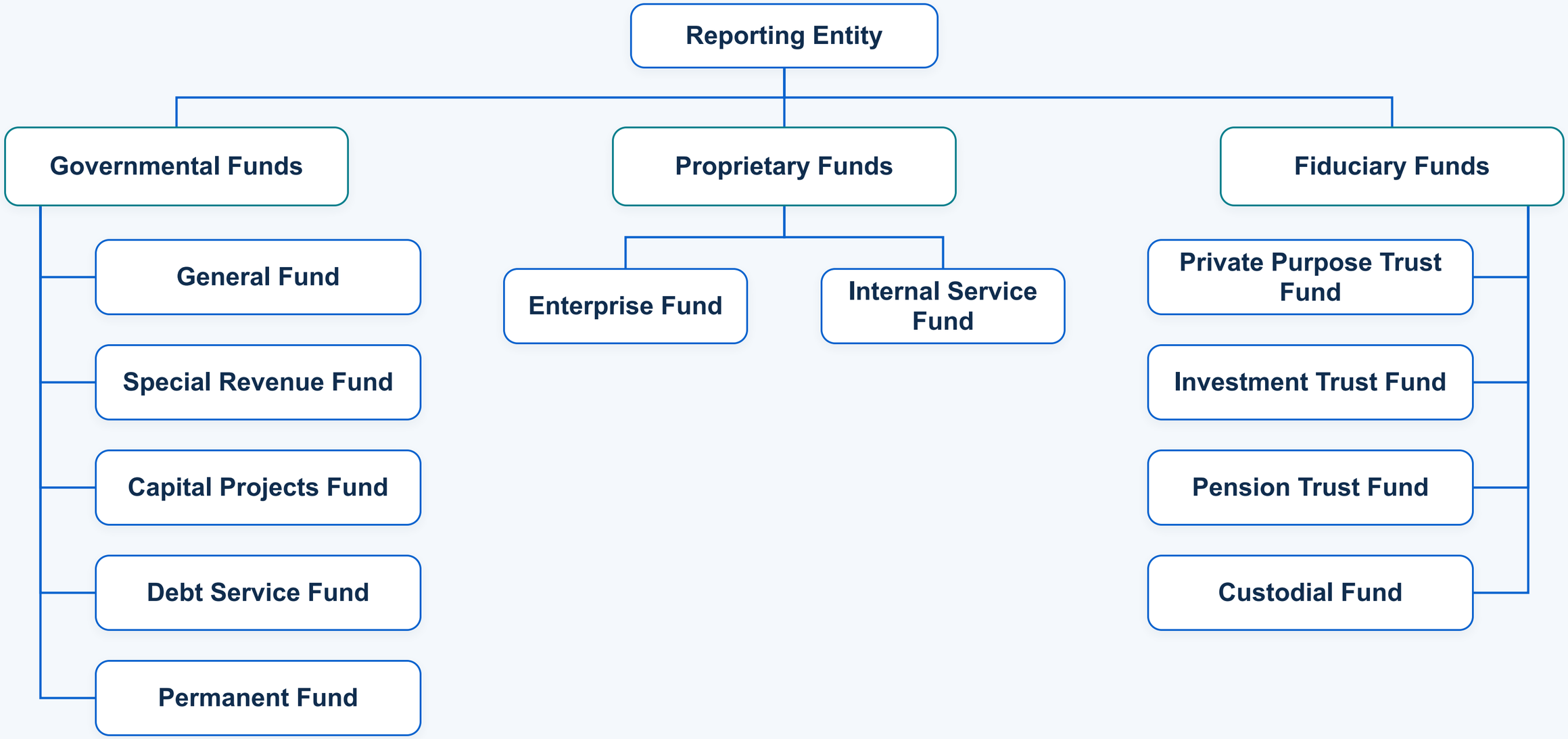
This more complex method applies **only** to companies that use the LIFO or retail inventory methods.

- **Step 1:** Determine the inventory's Cost.
- **Step 2:** Determine the designated **"**Market**"** value. The "Market" value is the middle value of the following three amounts:

1. **Replacement Cost**
2. **The Ceiling:** Net Realizable Value (NRV)
3. **The Floor:** NRV - Normal Profit Margin

- **Step 3:** Compare the Cost (Step 1) to the designated "Market" value (Step 2). The lower of the two is the amount reported on the balance sheet.

Governmental fund structure



Governmental fund structure (continued)

- General: everything not required to be reported in another fund.
- Special revenue: specific revenues restricted or committed to a purpose (not debt service or capital projects).
- Capital projects: acquiring or building capital assets.
- Debt service: principal and interest on general long-term debt.
- Permanent: principal kept intact; only earnings support the government's programs.
- Enterprise: services sold to the public for fees (required if debt is backed solely by fees, or law or pricing policy requires cost recovery).
- Internal service: services to other departments on a cost-reimbursement basis.
- Private purpose trust: trusts benefiting individuals, private organizations or other governments.
- Investment trust: external portion of investment pools.
- Pension trust: pension and other employee benefit plans held in trust.
- Custodial: other fiduciary activities not held in a trust (e.g., taxes collected for other governments).

Measurement focus and basis of accounting

	Measurement Focus	Basis of Accounting
Government-wide statements	Economic resources	Accrual
Governmental fund statements	Current financial resources	Modified accrual
Proprietary fund statements	Economic resources	Accrual
Fiduciary fund statements	Economic resources	Accrual

Net position

A = L + E (Normal Equation)
Assets + deferred outflows - liabilities - deferred inflows = Net position (net investment in capital assets, restricted, unrestricted)

Assets and deferred outflows of resources
− Liabilities and deferred inflows of resources
= Net position

Beginning and end of year journal entries

Beginning of Year

The difference between estimated revenues and appropriations goes to budgetary fund balance (the budgetary “equity account”).

Note: Credit appropriations control below includes transfers and estimated expenditures. CPA Exam questions often show separately budgeted transfers.

The journal entry that records budgeted amounts for estimated revenue and approved expenditures (appropriations) is posted on the opposite side of the “T” account compared with actual amounts.

DR	Estimated revenue control	$4,000,000	
DR	Budgetary fund balance (negative/deficit)	-	
CR	Appropriations control		$3,900,000
CR	Budgetary fund balance (positive/surplus)		$100,000

Beginning and end of year journal entries (continued)

End of Year

The budget is reversed and closed. Journal entry uses the same amounts recorded at the beginning of the period +/- amendments.

The journal entry at period end to reverse the budget is always for the same dollar amounts as the original budgetary journal entry +/- amendments.

DR	Appropriations control	$3,900,000	
DR	Budgetary fund balance (positive)	$100,000	
CR	Estimated revenue control		$4,000,000
CR	Budgetary fund balance (negative)		-

Fund balance classifications

1. Nonspendable Fund Balance: Amounts that cannot be spent. Nonspendable includes resources not in spendable form and amounts required to remain intact, including permanent-fund principal.

2. Restricted Fund Balance: Fund balance resources associated with assets restricted externally (creditors, grantors, other governments' laws) or by the constitution or enabling legislation.

3. Committed Fund Balance: Fund balance resources associated with assets obligated by a formal action of the government’s highest decision-making authority (e.g., resolutions by a city commission). Significant encumbrances require note disclosure. Classify encumbered resources under the applicable restricted, committed, or assigned criteria.

4. Assigned Fund Balance: Fund balance resources associated with assets the government intends to obligate (e.g., designations) but not formally committed. Assignments are not possible if unassigned fund balances are negative.

5. Unassigned Fund Balance: Fund balance resources associated with spendable assets neither restricted, committed, nor assigned. Residual equity classification for general fund; only general fund should have positive unassigned fund balance. Other governmental funds may have negative unassigned fund balances if expenditures for purposes exceed the amounts restricted, committed, or assigned to those purposes.

Fund balance constraints by level

Nature/Source of Constraints by Level: Summary	
Categories	**Nature of Constraint**
Nonspendable	Not in spendable form (inventory, prepaids) or legally required to be kept intact (permanent fund principal).
Restricted	External: Legislation, grantor, or creditor requirements must be satisfied
Committed: formal constraints imposed by the highest decision-making authority. Encumbrances are not synonymous with commitments.	Internal: Highest governing authority establishes limits
Assigned: intended specific uses that are neither restricted nor committed. Appropriations are not synonymous with assignments.	Internal: Intention without formal commitment (designation)
Unassigned	No constraint as to use

Fund balance constraints by fund

Typical classifications by fund: positive unassigned appears only in the general fund; any class may appear where its criteria are met.

Reported Constraints by Fund: Summary					
Categories	General	Special Revenue	Debt Service	Capital Projects	Permanent
Nonspendable	✓	✓			✓
Restricted	✓	✓	✓	✓	✓
Committed	✓	✓	✓	✓	
Assigned	✓	✓	✓	✓	
Unassigned	Positive or negative ✓	Negative ✓	Negative ✓	Negative ✓	Negative ✓

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1. This guide covers the **minimum** you should have memorized before exam day.
2. Mastery comes through repetition. Don't just read it once and call it done!

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- Alternate between this guide ⇒ flashcards ⇒ guide ⇒ flashcards for optimal retention.
- Our flashcards use advanced spaced repetition to build long-term memory more easily.
- Aim to memorize both the guide **and** flashcards for a comfortable pass.

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- Every formula, table, and concept in this guide represents potential "free points" on the exam, especially on straightforward memorization-based questions. Aim to score 100% on the easy memorization-based questions.
- Consistent practice is key. Dedicate time each day to rewrite formulas and review concepts.

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Congratulations on finishing this memorization guide!

FAR

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