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2021 SuperfastCPA Review Notes

[Updated for the July 2021 changes]

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I. CONCEPTUAL FRAMEWORK AND FINANCIAL REPORTING

A. CONCEPTUAL FRAMEWORK AND STANDARD-SETTING FOR BUSINESS AND NONBUSINESS ENTITIES

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1. CONCEPTUAL FRAMEWORK

The conceptual framework is the "guiding principles" of GAAP and for FASB when setting new standards.

The main idea behind the framework is to make financial reporting useful for making decisions.

Another key idea is that the benefits of financial reporting should outweigh the costs.

There are two primary qualitative characteristics and their components (know which components go with each characteristic):

- Faithful Representation
  - Completeness: Are all necessary facts included in the information
  - Neutral: The information is free from bias
  - Free from error: Info doesn't contain any material errors
- Relevance
  - Predictive value: Does it help make predictions about future events?

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- Confirmatory value: Does it provide information about earlier expectations or predictions?
- Material: Does the information matter to the user? (from a size/scope standpoint)

There are four enhancing characteristics:

- Comparability: Can the info be used to compare to other companies in the same industry(consistency)
- Verifiability: Independent observers would reach the same conclusion
- Timeliness: The info is recent enough to make a decision with
- Understandability: A user with a reasonable understanding of business can understand and draw conclusions from the information

Generally Accepted Accounting Principles (GAAP)

GAAP addresses three main aspects of financial reporting:

- Recognition: when an item is recorded on financial statements
- Measurement: how an item is recorded on financial statements
- Disclosure: disclosing anything not on the financial statements

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2. STANDARD-SETTING PROCESS

- First a project gets added to the agenda
- Second, they conduct research and issues a discussion memorandum
- Third, they hold public hearings on the topic
- Fourth, they evaluate research and comments from interested parties and then issue an Exposure Draft, this is the first version of the new standard
- Fifth, they solicit additional comments and modify the exposure draft if needed
- Sixth, they finalize the new accounting guidance by a vote, they need a majority vote which is 4 out of the 7 FASB members. If approved, they issue the new standard as an Accounting Standard Update (ASU)

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B. GENERAL PURPOSE FINANCIAL STATEMENTS

1. BALANCE SHEET/STATEMENT OF FINANCIAL POSITION

The balance sheet reports economic resources and obligations as of a specific date. The main premise of the balance sheet is the accounting equation: Assets = Liabilities + Shareholders' Equity.

The order of items on a balance sheet is:

- Current assets
- Long term assets
- Short term liabilities
- Long term liabilities
- Shareholders' equity

Assets are presented in order of liquidity (cash at the top).

Current assets are assets expected to be used up within one year.

Examples of current assets:

- Cash
- Inventory
- Prepaid expenses
- Accounts receivable
- Short term investments

Examples of long-term assets:

- Property, plant, and equipment

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- Investments
- Goodwill
- Patents

Current liabilities are liabilities expected to be resolved within one year. They are presented in order of maturity, usually starting with accounts payable.

Examples of short-term liabilities:

- Accounts payable
- Short term debt
- Bonds or dividends payable within the next year
- Income tax payable
- Accrued expenses
- Deferred revenue

Examples of long-term liabilities:

- Notes payable
- Capital lease obligations
- Bonds payable (noncurrent)

In comparison to the income statement, which shows a period of time - such as January 1 to December 31 - the balance sheet is just showing what a company has as of a certain date, usually December 31.

Other things to know:

Common ratios used to analyze a balance sheet:

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Current ratio: This is used to evaluate current assets compared to current liabilities, or: Does the company have enough short-term resources to cover their short-term liabilities? You want to see a ratio of at least 1 to show that the company has more current assets than current liabilities.

$$Current\ Ratio = \frac{Current\ Assets}{Current\ Liabilities}$$

Quick ratio: This is a more telling version of the current ratio, with inventory taken out of the equation.

$$Quick\ Ratio = \frac{(Current\ Assets - Inventory)}{Current\ Liabilities}$$

Debt to equity ratio: The ratio of what is owed to what is owned.

$$Debt\ to\ Equity = \frac{Total\ Liabilities}{Shareholders'Equity}$$

Other things to know:

Goods that are out on consignment should be included in the company's inventory at their cost.

Money collected in advance for a product will go in the liabilities section as deferred revenue. The transaction has created a "liability" to provide goods or services to the customer who has now paid in advance.

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Gift cards/gift certificates: They are deferred revenue until they are either used and become revenue, or if they expire, they become revenue when they expire.

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2. INCOME STATEMENT/STATEMENT OF PROFIT OR LOSS

On the income statement, revenues and expenses are from direct business activities, and gains or losses result from non-business activities such as a manufacturing company selling old equipment.

The income statement is organized to show a company's activities for the year with the end result being net income.

Here's how a multiple step income statement is organized:

Sales

- COGS

= Gross income

- Selling, general & admin expenses

- Depreciation

Equals operating income

+/- Misc. revenue/gains/expenses/losses (interest income, misc. expenses)

= Income before tax

- Income tax expense

= Income from continuing operations

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+/- Income from discontinued operations

= Net income

Multiple Step Income Statement vs Single Step Income Statement

A single step income statement is very simplified and just lumps revenues and gains together and then expenses and losses together, netting the two leaving net income.

The multiple step income statement breaks things out so that investors can see gross profit, operating income, and then non-operating revenue/gains/losses separate from operating income, which all together is income from continuing operations. The last item is income from discontinued operations - if there is any - and then finally net income.

Discontinued Operations

The discontinued operations portion (if any) appears below continuing operations on the income statement.

The important thing to know about discontinued operations on the income statement, is that they are presented net of tax. Also, the "results of operations" are presented on one line, and then the gain or loss on the "disposal of the business segment" is reported on a separate line.

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Example:

During 2018 ABC decides to dispose of business segment B. At the end of the year, segment B has generated $100,000 in income, and the result of disposing of B is a loss of $300,000. ABC's tax rate is 20%.

Here's what would appear on the income statement:

Discontinued Operations:

Results of Operations of Segment B (less income tax of $20,000): $80,000

Loss on disposal of Segment B (less tax savings of $60,000): ($240,000)

This results in an overall loss of $160,000 (240,000 - 80,000).

Other things to know:

Amortization of a discount on a note payable is an interest expense (it is a contra liability on the balance sheet and as it's amortized it's recognized on the income statement as an interest expense).

Know how to do problems where you're given amounts from different accounts that flow into each other to determine an ending amount being asked in the question.

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Example:

ABC had the following transactions in year 1:

- Disbursements for inventory purchases: $300,000
- Increase in accounts payable: $20,000
- Decrease in inventory: $30,000

To determine cost of goods sold for the year, you know that beginning inventory + purchases - ending inventory = COGS. Purchases are $300,000, and accounts payable increasing $20,000 for the year means that purchases exceeded cash payments by $20,000, so you'd add the $20,000. Inventory decreasing $30,000 would mean more inventory was sold than was purchased, so this would also be added, for COGS of $350,000.

You could be given the basic facts about a transaction and then asked where it would be reported on the income statement.

Example:

ABC purchased new sales software to run its stores. ABC expects to use the software for 10 years. How would this be reported on a multiple step income statement?

This is a simple depreciation question. ABC would include 1/10th the cost in the SG&A section of the income statement because it's simply the depreciation amount for one year. It wouldn't be in COGS, nor would the full amount of the purchase be included all in the first year.

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Common ratios to analyze income statement:

Gross margin: Gross profit / net sales. This measures the percentage of sales available for expenses and profit after subtracting COGS.

Profit margin: Net income / net sales. This measures the percentage of sales that becomes profit.

Earnings per share: Net income / weighted avg. # of common shares outstanding. Measures net income on a per share basis. (this is obviously simplified and will be discussed in more detail in an upcoming section)

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3. STATEMENT OF COMPREHENSIVE INCOME

The idea behind comprehensive income is to show a total picture of all operating income, gains, & losses.

Net income + other comprehensive income = Comprehensive income.

“Other Comprehensive Income” items

- Unrealized gains or losses on AFS securities
- Unrecognized gains or losses from pension costs
- Foreign currency translation adjustments
- Unrealized gains or losses from certain derivative transactions

Comprehensive income can be presented two ways:

In combination with the income statement: Other comprehensive income would be added just below ‘net income’.

Or as a separate statement: You’d have the income statement and a separate statement of comprehensive income. The separate statement starts with net income and then reports other comprehensive income.

Reclassification Adjustments

“Accumulated other comprehensive income” (AOCI) is reported in the shareholders’ equity section of the balance sheet. The OCI items are accumulated there until the gain is realized (such as an AFS security actually being sold), and then will be reclassified through net income and the AOCI is reduced by that amount, otherwise these gains would

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be counted twice. These reclassification adjustments are reported in the notes to the financial statements.

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4. STATEMENT OF CHANGES IN EQUITY

This statement shows changes during the year for the following items:

- Common stock
- Preferred stock
- Additional paid-in-capital
- Retained earnings
- Treasury stock
- AOCI

It can be part of the footnotes, or as a separate statement. Public companies show 3 years of comparative owners' equity on their statement of changes in equity.

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5. STATEMENT OF CASH FLOWS

Statement of cash flows is to show the changes in cash during the period.

Users want to know about a company's ability to generate and control cash in order to assess the company's ability to meet its obligations.

There are three types of cash flows on a cash flow statement:

- Operating: Changes in cash resulting from business operations
    - Cash received from customers
    - Dividend income
    - Interest income/expense
    - Cash paid for business expenses
- Investing: Changes in cash resulting from investing activities
    - Purchase/sale of investments or long-term assets
    - Making loans (getting a loan would be financing)
- Financing: Changes in cash resulting from financing activities
    - Issuing and selling company stock
    - Purchasing treasury stock
    - Getting a loan (also making payments on a loan)
    - Paying dividends
    - Issuing bonds

Most common mistakes on this: Dividends received are part of net income and therefore an operating activity. Dividends paid are a financing activity. Interest expense is an operating activity, as is interest income. Also read questions carefully to identify non-cash

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transactions… they aren’t classified on the statement of cash flows if no cash is involved.

Non-cash activities: There can be transactions that are significant but don’t affect cash, and so would not be part of the statement of cash flows. An example would be converting debt into stock. These would be reported in the notes to the financials or in a separate schedule.

Difference in the Direct vs Indirect Method of Cash Flow Statement

The only real difference in the two methods deals with the operating activities section: in the direct method, each line is a “direct” statement showing cash paid or received such as “cash paid to customers” or “cash paid to suppliers”. On an indirect statement, operating activities starts with net income and works backwards to “cash provided by operating activities”, and several non-cash items such as depreciation expense or gain/loss on sale of equipment. You’ll notice in the example below that the investing and financing sections are essentially the same. It’s only the operating section that differs.

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Indirect Method		
Cash flows from operating activities		
Net income		$50,000
Depreciation expense	10,000	
Decrease in accounts receivable	5,000	
Increase in inventory	(20,000)	
Increase in accounts payable	5,000	
Gain on sale of equipment	(3,000)	
Net cash provided by operating activities		**47,000**
Cash flows from investing activities		
Sale of land	15,000	
Sale of equipment	10,000	
Purchase of equipment	(40,000)	
Net cash used for investing activities		**(15,000)**
Cash flows from financing activities		
Sale of common stock	40,000	
Payment of dividents	(20,000)	
Net cash provided by financing activities		**20,000**
Net increase in cash		**$52,000**

Direct Method	
Cash flow from operating activities	
Cash received from customers	$80,000
Cash paid to suppliers	(20,000)
Cash paid to employees	(15,000)
Cash received for interest	2,000
Net cash provided by operating activities	**47,000**
Cash flows from investing activities	
Sale of land	15,000
Sale of equipment	10,000
Purchase of equipment	(40,000)
Net cash used for investing activities	**(15,000)**
Cash flows from financing activities	
Sale of common stock	40,000
Payment of dividents	(20,000)
Net cash provided by financing activities	**20,000**
Net increase in cash	**$52,000**

When using the indirect method, you are taking net income (accrual basis) and converting it to cash basis. Here are a few common items and how they relate when doing so:

- A change in assets means cash moved in the opposite direction.
- A change in liabilities means cash moved in the same direction.

Examples:

- Increase in inventory means less inventory sold than purchased, this is a subtraction from net income.
- Decrease in inventory means more inventory sold than purchased, this is an addition to net income.
- Increase in a payable means more accrued than paid, so this is added to net income.

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- Increase in a receivable means more accrued than received, so this is subtracted from net income.
- Depreciation expense is noncash but reduces net income on the accrual basis, so it is added to net income.

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6. NOTES TO FINANCIAL STATEMENTS

Disclosures are a key part of the financial statements in that they provide info about assumptions and estimates.

Managements' Discussion and Analysis

This is a required part for publicly held companies, it discusses operations, liquidity, and capital resources.

Significant Accounting Policies

There needs to be disclosures on significant accounting policies and how they are applied. Some of the items should be included if applicable:

- A company's revenue recognition policies
- How a company determines what investments are cash equivalents
- How a company prices their inventory
- Methods for amortizing intangibles

Other Disclosures

During times of price instability, a disclosure is required discussing the effects of the instability on the company's business.

Related party transactions: Any significant related party information would be discussed in the notes.

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Concentration of credit risk: If a business and most of its customers/suppliers all operate in the same industry, then a concentration of credit risk needs to be disclosed in the notes.

Contingent liabilities: Remember that possible liabilities that are not both probable and can be reasonably estimated (if it was both it would be on the balance sheet) would be discussed in the notes instead being accrued on the balance sheet.

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7. CONSOLIDATED FINANCIAL STATEMENTS

Consolidated financials present the assets, liabilities, equity, income, expenses, and cash flows of a parent company and its subsidiaries as one economic entity.

Some definitions:

Controlling interest: One entity has control of another if it owns more than 50% of that entity. A parent company must consolidate any subsidiaries under its control.

Non-controlling interest: An ownership stake of less than 50% of an entity.

Variable interest entity (VIE): An entity that is controlled by another entity, but not through voting rights. A VIE has a primary beneficiary, and when the beneficiary is a company, the company will consolidate the VIE's holdings onto its balance sheet and produce consolidated financial statements. A VIE is usually setup by the controlling entity to perform a specific business purpose.

A private company doesn't need to apply these VIE rules if the reporting entity and the legal entity aren't a public company, and aren't under common control of a public company.

Primary beneficiary: In this instance we're talking about the primary beneficiary of a VIE. The "test" for being the controlling interest in a VIE is the following and requires all three:

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2. The direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights
3. The obligation to absorb losses of the entity if they occur
4. The right to receive returns from the entity if they occur, which is compensation for taking the risk to absorb the entity's losses

At the date of consolidation, the assets and liabilities of the parent and sub are combined on the balance sheet, but the income statement and statement of cash flows will only show from the parent, because their operations weren't combined until that date.

Example:

ABC purchases 100% of the common stock of XYZ for $100,000 when XYZ's net assets are $75,000.

	Pre-Consolidation			*Consolidated*
	ABC	**XYZ**		**ABC**
Current assets	100,000	50,000	- 100,000 ABC's cash	50,000
Noncurrent assets	200,000	100,000	+ 25,000 of Goodwill	325,000
Total assets	300,000	150,000		375,000
Current liabilities	50,000	25,000		75,000
Noncurrent liabilties	100,000	50,000		150,000
Total liabilities	150,000	75,000		225,000
Equity	150,000	75,000	-75,000 XYZ's equity	150,000
Total liabilities and equity	300,000	150,000		

Since XYZ's net assets are $75,000 and the price paid to acquire XYZ is $100,000, ABC recognizes $25,000 of goodwill. ABC's cash goes down

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by $100,000, and XYZ's equity is removed in the consolidated balance sheet.

Calculating Goodwill in a Consolidation

Goodwill in a consolidation is the difference between the cost of the acquired business and the fair value of the net assets. A lot of these types of problems will point out that one or more of the assets being acquired is listed on the books for less than its fair value. So you need to take the book value of the assets and add any fair value missing from the book value to get to the total fair value. This subtracted from the cost of the acquisition will give you the goodwill amount.

Example:

ABC purchased all the stock of XYZ for $500,000. XYZ's net assets had a book value of $300,000, but a piece of land on the books had a fair value of $50,000 more than its book value. In this case, ABC would show goodwill of $150,000 after the acquisition: 500,000 - 350,000 total fair value of assets = $150,000.

Issuance Costs/Legal Fees in a Consolidation

Costs to register and issue stock to acquire another company are netted against the paid-in capital account upon consolidation. Legal or consulting fees due to the consolidation are just expensed as incurred.

All intercompany transactions must be removed on consolidated statements, or else the level of activity would be overstated for both entities.

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A downstream transaction is when the parent sells to the sub. An upstream transaction is when the sub sells to the parent.

The following transaction types need to be eliminated in consolidated statements:

- Intercompany receivables/payables
- Intercompany revenues/expenses
- Intercompany inventory
- Intercompany fixed assets
- Intercompany bonds

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C. GENERAL-PURPOSE FINANCIAL STATEMENTS: NONGOVERNMENTAL, NOT-FOR-PROFIT ENTITIES

1. STATEMENT OF FINANCIAL POSITION

The statement of financial position is the 'balance sheet' for not for profit (NFP) organizations. The main difference is the "net assets" portion instead of shareholders' equity, since there are no shareholders in an NFP.

So it's broken down into assets, liabilities, and net assets. And again, assets = liabilities + net assets.

Net assets section:

The net assets section is broken out into two categories of net assets:

1. Net assets without donor restrictions
2. Net assets with donor restrictions

Net assets without donor restrictions

These are assets that have no restrictions and that the NFP can use how they want.

Net assets with donor restrictions

These are net assets with either a time restriction, purpose restriction, or even a permanent restriction. All restrictions are set by the donor at the time of the donation.

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2. STATEMENT OF ACTIVITIES

The statement of activities focuses on the changes in each group of net assets, so there are 3 main segments on the statement:

1. Changes in net assets without donor restrictions
   - Starts with "Revenues and gains", this includes contributions, fees and investment gains free from donor restriction
   - Next is "net assets released from restriction"
   - Then "Expenses and losses", which are broken out by program
   - Note that all expenses for the NFP will be listed in the unrestricted section
2. Changes in net assets with donor restrictions
3. Changes in permanently restricted net assets

Other things to know:

For NFPs, unrealized gains and dividends from investments are included on the statement of activities for the year, and stay within the designation of the original investment, such as net assets with no donor restrictions or net assets with a donor restriction.

Example:

ABC, a NFP, made an investment of $100,000 using funds with no donor restrictions in Beta corp stock. At the end of the year, the investment in Beta had a FMV of $120,000, and ABC received dividends of $5,000 from Beta. As a result, ABC would include an increase in net assets with

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no donor restrictions of $25,000 for the year: The $20,000 increase in FMV + the $5,000 in dividends.

Reporting Expenses by Nature and Function (Statement of Functional Expenses)

Previously the statement of functional expenses was only required by “voluntary health and welfare organizations”, but now every NFP is required to report expenses by nature and function.

This can be done 1) within the statement of activities, 2) as a schedule in the notes to the financial statements, or 3) as a separate financial statement.

By “nature and function”, it means that expenses are broken out to show what was spent on “program services” and “supporting services”.

Program services are expenses directly related to the programs that fulfill the mission of the NFP.

Supporting services are management and general expenses, and fund raising.

Note that any given expense can be allocated to both the program services and supporting services, such as the salary of employees, depending on their role with the NFP.

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Updated Definition of a "Collection" and Use of Proceeds

A recent update changed that when an entity sells a "collection", proceeds from the sale can be used to either acquire new items or directly care for existing items already in possession. Previously the proceeds could only be used to acquire additional collections.

"Collections" refers to groupings of art, historical treasures or similar items that are 1) held for the public, 2) preserved and protected, and 3) when sold, the proceeds are reserved for specific uses.

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3. STATEMENT OF CASH FLOWS

The statement of cash flows for NFP is just like the statement of cash flows for regular businesses.

The changes in net assets is part of the operating activities section. Unrestricted cash transactions will be reflected in the operating activities section, but any cash transactions with long-term restrictions appear in the financing section. Also, dividends received on investments with long-term restrictions would also be included in the financing activities section.

The investing activities section contain the same types of transactions that would appear in the investing section of a regular statement of cash flows.

Just like regular statements of cash flows, these can be prepared under either the direct or indirect method.

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D. PUBLIC COMPANY REPORTING TOPICS

Regulation S-X

Regulation S-X governs the form and content of financial statements and financial disclosures, such as the balance sheet, income statement, shareholders equity statement, cash flow statement, and footnotes.

Regulation S-K

Regulation S-K governs the form and content of nonfinancial disclosures, such as the description of the business, management's discussion and analysis (MD&A), information on management.

Filer Types:

Large accelerated filer: A company with market value of $700 million or more. Needs to file the 10-K within 60 days of fiscal year end, and the 10-Q within 40 days of end of quarter.

Accelerated filer: A company with market value between $75 and $700 million and annual revenues of $100 million or more. Needs to file the 10-K within 75 days of fiscal year end, and the 10-Q within 40 days of end of quarter.

Nonaccelerated filer: A company with market value of less than $700 million with annual revenue of less than $100 million, or a market value of less than $75 million. Needs to file the 10-K within 90 days of fiscal year end, and the 10-Q within 45 days of end of quarter.

Form 10-K

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Form 10-K is the annual filing or “annual report”. The 10-K must be audited by an independent, registered auditor.

The 10-K is organized into 4 main parts:

1) Part 1
    - Description of the business
    - Risk factors
    - Properties & physical assets of the business
    - Legal proceedings
2) Part 2
    - Market price of stock overview
    - Consolidated financial info
    - Management’s discussion & analysis
    - Financial statements (going concern opinion)
    - Changes in disagreements with accountants
    - Controls & procedures
3) Part 3
    - Directors, executives, and corporate governance
    - Executive compensation
    - Security ownership of certain beneficial owners
    - Certain relationships, related party transactions
    - Principal accounting fees and services
4) Part 4
    - Exhibits, financial statement schedules, and signatures

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Form 10-Q

Form 10-Q is the quarterly filing. The 10-Q is not audited but is reviewed by an auditor. Disclosures in the 10-Q are not nearly as extensive as in the 10-K.

The 10-Q includes the following reviewed financial statements:

- Balance sheets: an interim balance sheet for the most recent fiscal quarter, and a balance sheet for the end of the preceding year
- Income statement: quarterly and year to date income statements for current year and preceding year
- Cash flow statement: year to date and preceding year cash flow statements

Form 8-K

Form 8-K is for significant or "material" events that happen between 10-Ks and 10-Qs. These might include a bankruptcy, departure of a CEO, triggering events for material obligations, delisting from a stock exchange, change in accountants, etc.

Earnings Per Share

Basic earnings per share:

The formula for basic earnings per share is:

$$\frac{Net\ Income - Preferred\ Stock\ Dividends}{Weighted\ Avg\ \#\ of\ Outstanding\ Common\ Shares}$$

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For the weighted average aspect, you'll see questions like this:

ABC corp has net income of $150,000 for 2018 and paid preferred stock dividends of $50,000. At the beginning of 2018, ABC had 1,000 outstanding shares of common stock. On July 1st, ABC issued another 500 shares of common stock. On October 1st, ABC issued another 100 shares. What was ABC's basic earnings per share for 2018?

Here's how to calculate the weighted average # of shares:

Date	Shares	Weight	Weighted Average
January 1st	1,000	12/12	1,000
July 1st	500	6/12	250
October 1st	100	3/12	25
		Weighted Avg. # of Shares	1,275

So then the calculation for earnings per share would be $100,000 / 1,275 = $78.43 EPS.

Note: If the problem includes a stock dividend or stock split at some point during the year, these are treated as being outstanding the whole year, so the weighting doesn't apply.

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Diluted earnings per share

The idea is to calculate what the EPS would be if all possible shares were outstanding. This is because at any given time, a company might have millions of stock options or convertible bonds that would significantly impact the EPS if all those shares were outstanding.

There are things that can affect both the numerator and denominator in the diluted EPS calculation.

Items affecting the numerator:

- With convertible bonds, the interest expense needs to be added to net income in the numerator (but net of tax)

Items affecting the denominator:

- First, only dilutive (items that would lower EPS) potential common stock will be included. For convertible bonds it's possible that when adding back interest expense to the numerator and the potential shares to the denominator that it's actually non-dilutive, is so it wouldn't be used in the calculation of DEPS. This can also happen with stock options or warrants, see below.
- For stock options or warrants:
    - Assume the options are exercised, and that the company buys back as many shares as it can based on the exercise price
    - Example: 100 shares at $10 exercise price with market value of $25 = proceeds of $1,000 so they buy back 40 shares @

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$25/share. This means the remaining 60 shares would be added to the denominator, and would be dilutive

- Note: If the option price exceeds the market price, this would be non-dilutive, and you wouldn't use the number

- For convertible bonds, assume the bonds are converted to shares and add the shares to the denominator
  - Example: 10 convertible bonds each convertible to 50 shares, so if converted there would be 500 shares. Add 500 to the denominator

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E. FINANCIAL STATEMENTS OF EMPLOYEE BENEFIT PLANS

Defined Benefit Pension Plan

With a defined benefit pension plan, there are different inputs and the annual retirement benefit is defined. The big thing with these is the annual pension expense and the ending liability, or the “projected benefit obligation”.

The required financial statements are:

- A statement of net assets available for benefits as of the end of the plan year (ERISA requires this to be in comparative format)
- A statement of changes in net assets available for benefits for the year then ended
- Information regarding the actuarial present value of accumulated plan benefits
- Information regarding the effects, if significant, of certain factors affecting the year-to-year change in accumulated plan benefits

Defined Contribution Pension Plan

The financial statements required are:

- A statement of net assets available for benefits as of the end of the plan year.
- A statement of changes in net assets available for benefits

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In a defined contribution plans, the annual employer contribution is defined, and the performance is up to the employee.

These are much simpler to account for than defined benefit plans. The employer simply contributes a set annual amount into an investment account for the employee held by a third-party trustee.

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F. SPECIAL PURPOSE FRAMEWORKS

When preparing financial statements based on an “other comprehensive basis of accounting” (OCBOA), the statement of cash flows is not usually prepared. The important thing is that the statements are descriptive about what basis of accounting has been used. This will usually mean a descriptive title, or a title you’re used to, with the addition of the basis used in the title such as “Statement of Assets and Liabilities - Modified Cash Basis”

Cash Basis of Accounting

Under pure cash accounting, revenue is when cash is received, and expenses are when cash is spent. There isn’t really a balance sheet under pure cash accounting, and an “income statement” would be titled something like “Statement of Cash Receipts and Disbursements”.

Modified Cash Basis of Accounting

This is the cash basis plus a few elements of accrual accounting usually by capitalizing and depreciating assets or recognizing accounts receivable & accounts payable, and accruing income taxes due.

The statements would be titled something like “Statement of Assets and Liabilities - Modified Cash Basis” and “Statement of Revenues, Expenses, and Retained Earnings - Modified Cash Basis”.

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Tax Basis of Accounting

These statements obviously focus on presenting the information based on tax rules. There is a range of reporting certain aspects from cash basis to full accrual.

Again, the financial statement titles should specify the basis used such as “Statement of Revenues and Expenses - Income Tax Basis”.

Regulatory Frameworks

There are specific regulatory frameworks that have specific guidelines for financial reporting; these are considered an OCBOA, but you don’t need to know them all for the CPA exams.

Keeping with the idea that financial statements need to be clear about the basis they were prepared on, a title you might see for an income statement prepared under a regulatory basis might be “Statement of Income - Regulatory Basis”.

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