

Contents

SECTION I ADJUSTING THE ACCOUNTS

Learning Goal 1: Explain the Meaning of "Accounting Period" 3

Overview of Accounting Periods 3
The Need to Measure Change 4
The Best Way of Measuring Financial Change 7
Vocabulary 9
Practice 10

Learning Goal 2: Explain the Basic Principles for Recording Revenues and Expenses 12

Accrual Basis Accounting 12
Overview of Accrual Basis 12
Accrual Accounting Principles 14
Applying the Revenue Recognition Principle 15
Applying the Matching Principle 16
Cash Basis Accounting—A Simplified Alternative 19
Overview of Cash Basis 19
How to Apply Cash Basis 20
Illustration of Cash and Accrual Method Differences 21
Revenues 21
Expenses 22
Review and Vocabulary 23
Practice 24

Learning Goal 3: Explain the Concept of Adjusting Entries 32

Overview of General Features 32
Summary 32
What Are Adjusting Entries? 33
Why Adjusting Entries Are Needed 33
The Common Qualities of Adjusting Entries 33
Overview of Adjustment Types 36
The Five Causes of the Five Adjustments 36
Classification, Valuation, and Timing 37
Review 38

Learning Goal 4: Prepare Adjusting Entries for Prepaid Expenses 39

A Closer Look at Prepaid Expenses 40
Identify Prepaid Expenses 40
How a Prepayment Becomes an Expense 41
How to Adjust Prepaid Expenses 44
The Two Objectives 44
Objective I: Prepare the Adjusting Journal Entry 46
Step 1: Identify the Key Information Type 46
Step 2: Select the Proper Method to Calculate Cost Used Up 52

- Using Information Type 1: The Asset Cost Remaining 54
- Using Information Type 2: The Asset Cost Used Up 58
- Using Information Type 3: The Cost Per Unit of the Asset 61
- Using Combinations of Information Types 64

Step 3: Prepare the Adjusting Journal Entry 67
Objective II: Determine the New Balances of the Accounts Affected 69
Three Easy Steps 69
Practice 70

Learning Goal 5: Prepare Adjusting Entries for Unearned Revenues 73

A Closer Look at Unearned Revenue 74
Identify Unearned Revenues 74
How the Liability Becomes a Revenue 75
How to Adjust Unearned Revenues 76
The Two Objectives 76
Objective I: Prepare the Adjusting Journal Entry 78
Step 1: Identify the Key Information Type 78
Step 2: Select the Proper Method to Calculate the Revenue Earned 84

- Using Information Type 1: The Unearned Revenue Actually Remaining 86
- Using Information Type 2: The Unearned Revenue That Was Earned 89

- Using Information Type 3: The Unearned Revenue Per Unit 92
- Step 3: Prepare the Adjusting Journal Entry 96
- Objective II: Determine the New Balances of the Accounts Affected 98**
- Three Easy Steps 98
- Comparing the Two Deferrals 99**
- Prepaid Expense Compared to Unearned Revenue 99
- Review and Vocabulary 100**
- Practice 101**

Learning Goal 6: Depreciate Plant and Equipment Assets 105

- Subject Overview 105**
- Overview of Plant and Equipment 105
- Overview of Depreciation 106
- Calculating Depreciation and Making the Adjusting Entry 108**
- Calculating the Amount of Depreciation 108
- Making the Adjusting Entry 110
- Book Value 112**
- Definition and Examples 112
- Review and Vocabulary 114**
- Practice 115**

Learning Goal 7: Prepare Adjusting Entries for Accrued Revenues 119

- Overview of Accruals 120**
- Accrued Revenues and Accrued Expenses 120
- Accrual Adjustments 120
- A Closer Look at Accrued Revenues 121**
- Identify Accrued Revenues 121
- How to Adjust for Accrued Revenues 122**
- The Two Objectives 122
- Objective I: Prepare the Adjusting Journal Entry 124**
- Step 1: Identify the Key Information Type 124
- Step 2: Select the Proper Method to Calculate the Revenue Earned 127
- Step 3: Prepare the Adjusting Journal Entry 129
- Objective II: Determine the New Account Balances 131**
- Three Easy Steps 131
- What Happens in the Period After the Accrual? 132**
- Examples 132

Learning Goal 8: Prepare Adjusting Entries for Accrued Expenses 136

- A Closer Look at Accrued Expenses 136**
- Identify Accrued Expenses 136
- How to Adjust for Accrued Expenses 138**
- The Two Objectives 138
- Objective I: Prepare the Adjusting Journal Entry 140**
- Step 1: Identify the Key Information Type 140
- Step 2: Select the Proper Method to Calculate the Expense 142
- Step 3: Prepare the Adjusting Journal Entry 145
- Objective II: Determine the New Account Balances 147**
- Three Easy Steps 147
- What Happens in the Period After the Accrual? 148**
- Examples 148
- Review and Vocabulary 151**
- Practice 152**

Learning Goal 9: Know Which Adjustment You Need to Do 156

- How to Know Which Adjustment to Do 156**
- Overview of the Process 156
- Prepaid Expenses (Deferred Expenses) 157
- Unearned Revenues (Deferred Revenues) 159
- Depreciation 160
- Accrued Revenues 161
- Accrued Expenses 162
- The Simple System 163
- The Standard Forms of Adjusting Journal Entries 164
- Summary Table of All Adjustment Features 164
- Review and Vocabulary 166**
- Practice 167**

Learning Goal 10: Prepare and Use an Adjusted Trial Balance 185

- The Adjusted Trial Balance 185**
- Overview of the Adjusted Trial Balance 185
- Prepare Financial Statements from Adjusted Trial Balance 186
- Practice 189**

Learning Goal 11: Review the Accounting Cycle 190

- The Accounting Cycle Procedures 190
- Cumulative Vocabulary Review 192**

Cumulative Test	193
Cumulative Test Solutions	200
Help Table	202

SECTION II COMPLETING THE ACCOUNTING CYCLE

Learning Goal 12: Explain What a Worksheet Is and What It Does 204

Overview of Section II	204
Identify a Worksheet	204
What Is a Worksheet?	204
The Qualities of a Worksheet	207
Review and Vocabulary	207

Learning Goal 13: Prepare a Worksheet 208

The Five Steps	208
Step 1: Prepare the Trial Balance on the Worksheet	208
Step 2: Calculate the Adjustments and Enter Them in the Adjustments Column	209
Step 3: Enter Account Balances in the Adjusted Trial Balance Column	213
Step 4: Extend the Adjusted Trial Balance Amounts into the Financial Statement Columns	220
Step 5: Total the Financial Statement Columns and Compute the Net Income or Net Loss	222
Review	225
Practice	226

Learning Goal 14: Use the Completed Worksheet 232

Overview	232
The Three Results of Using a Worksheet	232
Result 1: Financial Statements	232
Result 2: Adjusting Entries	235
Result 3: A Source for the Closing Journal Entries	235
Review	235
Practice	236

Learning Goal 15: Prepare a Classified Balance Sheet 240

Concept and Example of Classification	240
Overview: The Concept of Classification	240
The Classified Balance Sheet	241

The Balance Sheet Classifications Explained	242
The Asset Classifications	242
The Liability Classifications	243
Example for Applegate Modeling Agency	244
Review and Vocabulary	246
Practice	247

Learning Goal 16: Prepare Closing Entries 253

Review of Owner's Equity	253
The Six Owner's Equity Accounts	253
The Concept of Closing	256
What Is <i>Closing the Accounts</i> ?	256
Use the Accounting Equation to Understand Closing	258
The Closing Procedure	260
Overview of the Four Steps to Close the Accounts	260
Simple T-Account Illustration of the Four Steps	263
Where to Find Account Balances for Closing	266
Journalizing the Closing Entries	267
The Post-Closing Trial Balance	270
How Quickly Must I Do the Closing After Period End?	270
Review and Vocabulary	271
Practice	272

Learning Goal 17: Describe the Complete Accounting Cycle 280

The Complete Accounting Cycle	281
Description	281
Illustration—The Accounting Cycle	282
Practice Set 1 Cumulative Problem	283
Cumulative Vocabulary Review	286
Cumulative Test	287
Cumulative Problem Solution	291
Cumulative Test Solutions	310
Help Table	312

SECTION III MERCHANDISING OPERATIONS

Learning Goal 18: Distinguish Service Operations from Merchandising Operations 315

Compare Service and Merchandising	315
Service and Merchandising Operations Defined	315

The Operating Cycles Compared 316
 Terminology of Income Calculations 318
 Income Calculation and Reporting 320
 Cost of Goods Sold 321
 Quick Comparison of Periodic and Perpetual 323
 How Do I Know Which Kind of Problem It Is? 324
Review and Vocabulary 325
Practice 326

Learning Goal 19: Explain How Sales Are Recorded and Reported 329

Net Sales 329
 When to Record Revenue 329
 Overview of Net Sales 331
 Sales Discounts 332
 Credit Terms 333
 Calculating Discounts 334
 Journalizing Payments from Customers 337
 Calculating and Recording Sales Returns and Allowances 342
Shipping Charges and Sales Tax 344
 Shipping Charges Paid by the Seller 344
 Sales Tax 345
Review 347
Vocabulary 348
Practice 349

Learning Goal 20: Explain and Use the Periodic Inventory Method 356

Overview 356
The Cost of Goods Sold Formula 358
 Overview of Income Calculation 358
 Formula for Cost of Goods Sold Calculation 359
Cost of Goods Available for Sale 362
 Overview 362
 Beginning Inventory 363
 Purchases 364
 How Purchases Are Made 366
 Purchase Discounts 366
 Calculating Purchase Discounts 367
 Journalizing Payments to the Sellers 368
 Purchase Returns and Allowances 370
 Freight-in 372
 Summary Illustration: Cost of Goods Available and Cost of Goods Purchased 375
 Comparison Table—Seller and Buyer Journal Entries 376

Ending Inventory 377
 Description 377
 How to Calculate Ending Inventory 377
 How to Report Ending Inventory 378
Review 380
Vocabulary 381
Practice 382

Learning Goal 21: Complete the Period-End Procedures—Periodic Method 389

Overview 389
Period-End Procedures: Closing System 390
 Completing the Worksheet: Closing System 390
 Financial Statements 401
 Recording Adjusting and Closing Entries: Closing System 405
Period-End Procedures: Adjusting System 409
 Overview 409
 Completing the Worksheet: Adjusting System 409
 Financial Statements 418
 Recording Adjusting and Closing Entries: Adjusting System 421
 The Gross Profit Percentage 425
Review and Vocabulary 426
Practice 427
Cumulative Vocabulary Review 437
Cumulative Test 439
Cumulative Test Solutions 446
Help Table 447

Learning Goal 22: Explain and Use the Perpetual Inventory Method 448

Overview 448
The Cost of Goods Sold Calculation 450
 Overview 450
 Optional Formula 451
Transactions That Involve Buying Merchandise 452
 Purchases 452
 Purchase Discounts 452
 Calculating Discounts 453
 Journalizing Payments for Purchases and Discounts 453
 Journalizing Purchase Returns and Allowances 454
 Journalizing Freight Costs 457
 Summary of the Merchandise Inventory Account 459
 Alternative Method for Discounts, Returns, Allowances, and Freight 460

Transactions That Involve Selling Merchandise 461

- Journalizing Sales Transactions 461
- Journalizing Sales Discounts 461
- Journalizing Sales Returns and Allowances 462

Shipping Charges and Sales Tax 464

- Shipping Charges Paid by the Seller 464
- Sales Tax 465

Comparing Journal Entries 468

- Comparison Table: Seller and Buyer
- Journal Entries 468

Ending Inventory 469

- Journalizing Ending Inventory Adjustments 469

Review 470**Vocabulary 471****Practice 472**

Learning Goal 23: Complete the Period-End Procedures—Perpetual Method 479

- Overview 479
- Completing the Worksheet 479
- Financial Statements 481
- Recording Adjusting Entries 484
- Recording Closing Entries 485
- The Gross Profit Percentage 487

Review and Vocabulary 488**Practice 489****Cumulative Vocabulary Review 499****Cumulative Test 501****Cumulative Test Solutions 507****Help Table 508****SECTION IV ACCOUNTING SYSTEMS**

Learning Goal 24: Identify an Accounting System and Explain Its Features 510

- Overview 510
- Definition and Main Features of Accounting Systems 512**
- Accounting System Defined 512
- The Essential Elements 512
- Growing Importance of Information Systems 513

Subsidiary Ledgers 515

- What Are Subsidiary Ledgers? 515
- Illustrations of Subsidiary Ledgers 517
- Solving Problems Using Subsidiary Account Information 518

Special Journals 520

- Overview 520
- What Is a Special Journal? 520
- Why Are Special Journals More Efficient Than General Journals? 521
- The Most Common Special Journals 521
- Features 523
- The Design and Use of a Purchases Journal 524
- The Design and Use of a Sales Journal 528
- Review: Posting Procedure for a Special Journal 530
- The Design and Use of a Cash Receipts Journal 534
- The Design and Use of a Cash Payments Journal 536
- Using the General Journal with Special Journals 540
- Overview of the Special Journals 542
- Special Journals for Service Businesses 542

Other Journal Types 543

- The Combination Journal 543
- See Special Journals As Reports 544
- Invoices As Journals 546
- Variations in Journals 546

Computerized Accounting Systems Overview 546

- Features Compared to a Manual System 546
- The Parts of the System 548
- Entering Data 550
- Different System Sizes 553
- Checklist for Computerized Accounting System Features 554

Review and Vocabulary 555**Practice 556****Practice Set 2 578****Practice Set 3 582****SECTION V ANALYSIS OF KEY ACCOUNTS**

Learning Goal 25: Report and Control Cash 588

Reporting Cash 589

- Cash Defined 589
- How Cash Is Reported on the Balance Sheet 590
- Cash Reported on the Statement of Cash Flows 591

Controlling Cash 591

- Internal Control 591
- Using a Checking Account 592

The Bank Reconciliation 597

- Overview 597
- Reconciling Items 598
- The Bank Reconciliation Procedure 602

Some Explanations and Practical Suggestions 604
 Bank Reconciliation Example 605
 What to Do When Your Reconciliation Does Not Reconcile 611
 Another Example 616
 A Tip and a Caution 624
The Petty Cash Fund 625
 Overview 625
 Establishing the Fund 625
 Petty Cash Payments 626
 Replenishing the Fund 627
Other Cash Payment Controls 629
 The Change Fund 629
 Credit Cards 630
Cash Payment Controls for Large Businesses 631
 Voucher System Overview 631
 Validation and Verification in a Voucher System 631
 Authorization and Recording in a Voucher System 632
 Payment in a Voucher System 633
 Variety of Voucher Systems 634
Cash Receipts Controls 636
 Procedures 636
 Comparison: Review of Internal Control for Cash Payments 638
Internet and E-Commerce Requirements 639
 Key Points 639
Summary of Internal Control Principles 640
 Overview 640
 Business Size 641
Review and Vocabulary 642
Practice 644

Learning Goal 26: Record, Report, and Control Receivables 663

Receivables 664
 Overview of Receivables 664
Valuation of Accounts Receivable 665
 Overview of the Process 665
 The Allowance Method 668
 Aging of Accounts Receivable 668
 Percentage of Net Sales 671
 Writing Off an Account 673
 Summary 674
 GAAP Weakness 675
 Direct Write-Off Method 676
 Adjustment for Sales Returns and Allowances 677

Disposing of Receivables 678
 Selling Receivables 678
 Internal Control for Accounts Receivable 679
Notes Receivable 681
 Calculating Simple Interest 681
 Note Transaction Examples 683
Financial Statement Presentation of Accounts and Notes Receivable 684
 Examples 684
Review 685
Vocabulary 686
Practice 687

Learning Goal 27: Record, Report, and Control Merchandise Inventory 701

Merchandise Inventory 702
 Cost of Inventory: Overview of the Issues 702
Assigning Costs Using the Periodic System 703
 Overview 703
 Inventory Data for the Methods Shown 704
 Periodic First-In, First-Out (FIFO) Method 705
 Periodic Last-In, First-Out (LIFO) Method 706
 Periodic Weighted Average Method 706
 Specific Identification Method 709
Assigning Costs Using the Perpetual System 710
 Overview 710
 Inventory Data for Methods Shown 710
 Perpetual First-In, First-Out (FIFO) Method 711
 Perpetual Last-In, Last-Out (LIFO) Method 713
 Perpetual Moving Average Method 714
 Comparison of FIFO, LIFO, and Moving Average 715
 A Practical Comparison of FIFO, LIFO, and Moving Average 716
Revaluing the Inventory 717
 Lower of Cost or Market 717
Inventory Errors 718
 Overview 718
 Analysis 718
Estimating Inventory 720
 Gross Profit Method 720
Internal Control for Inventory 722
 Essential Methods 722
GAAP Weakness 723
 Comparability and Reliability 723
Review 724
Vocabulary 725
Practice 726

Learning Goal 28: **Record, Report, and Control Fixed Assets and Intangibles 741**

Fixed Assets 742

Overview 742

Property, Plant, and Equipment 743

Acquisition of Property, Plant, and Equipment 743

Operations 744

Overview 744

Depreciation 745

Double-Declining Balance (200% Declining Balance) 745

Units-of-Production Depreciation 747

Income Tax Depreciation 747

Partial Year Depreciation 748

Using Fully Depreciated Assets 749

Changing the Estimated Useful Life 749

Misconceptions About Depreciation 750

Repairs and Maintenance 753

Disposition 753

Three Disposition Methods 753

Retired Assets 754

Sold Assets 754

Exchanged Assets 755

Impaired Assets 760

Overview 760

Internal Control for Plant and Equipment 761

Essential Methods 761

Natural Resources 763

Overview 763

Acquisition and Operation 763

Intangible Assets 765

Overview 765

Acquisition and Operation 766

Financial Statement Presentation 767

Fixed Assets and Intangible Assets 767

GAAP Weakness 768

Comparability and Reliability 768

Review 769

Vocabulary 770

Practice 771

Learning Goal 29: **Record, Report, and Control Current Liabilities and Payroll 784**

Current Liabilities 786

Summary 786

Contingent Liabilities 787

Current Portion of Long-Term Debt 788

Payroll 789

Overview of Payroll 789

Identify Employees 791

Employees 791

Independent Contractors 792

Statutory Employees 793

Employee Identification and Internal Control 793

Employee Identification in the Personnel Department 794

Calculate the Payroll 795

Overview 795

Gross Pay 796

Identifying and Calculating Gross Pay 796

Withholding 797

Overview 797

Employee Income Tax 798

Employee Social Security (FICA) 800

Other Required Withholding 802

Voluntary Deductions 802

Employer Payroll Taxes 804

Overview 804

Employer Social Security (FICA) 804

Unemployment Taxes 805

Employer Benefits Expense 807

Overview 807

Important Benefit Types 807

Internal Control for Payroll Calculation 808

Record the Payroll 809

Overview 809

The Payroll Register Illustrated 810

Journal Entry for the Gross Pay Expense 812

Journal Entry for the Employer Payroll Tax Expense 812

Journal Entry for the Benefits Expense 813

Employee Earnings Records 813

Make Payments 815

Overview 815

Payments to Employees 815

Payments to Taxing Authorities 816

Payments to Other Parties 817

Internal Control for Payroll Payments 817

Submit Required Forms and Reports 820

Key Items 820

The Use of Computers in Payroll 821

Overview 821

Financial Statement Presentation of Payroll Items 822
Key Ideas 822
Review and Vocabulary 824
Practice 826

SECTION VI FINANCIAL STATEMENT ANALYSIS

Learning Goal 30: **Analyze Financial Statements 839**

Financial Statements Quick Review 840
Balance Sheet 840
Income Statement 841
Statement of Owner's Equity 841
Statement of Cash Flows 841
Trend Analysis Using a Reference Base 844
Overview 844
Horizontal Analysis 845
Vertical Analysis 847
Combined Horizontal and Vertical Analysis 849
Common-Size Statements 849
MD&A 850
Overview 850
Ratio Analysis 851
Overview 851
Interpreting Financial Ratios 851
Measures of Liquidity 853
Measures of Solvency 857
Measures of Profitability 861

Measures of Investment Return 864
Measures of Productivity 865
Analysis as an Outsider 867
Overview 867
Finding Information 868
Quality of Earnings 869
Overview 869
Earnings Management 869
Potentially Hidden Liabilities 874
Overview 874
Contingent Liabilities 874
Off-Balance-Sheet Financing 876
Conclusions 879
Financial Statement Usefulness 879
The Public Response 880
Review 884
Vocabulary 885
Practice 886

Appendix: Checklist of Computerized Accounting Functions and Features 896
Glossary 901
Subject Index 909
Essential Math Index 917

Computer Disk (Back of Book)
Solutions to All Problems by Learning Goal
Additional Techniques
Essential Math for Accounting
Accounting Paper Templates for Volume 2