

WEYGANDT • KIESO • KELL

ACCOUNTING PRINCIPLES

FOURTH EDITION

Ricochet:

The Accounting
Web Tutor

Log in to <http://ricochet.uol.com>

FOURTH EDITION

ACCOUNTING PRINCIPLES

► **JERRY J. WEYGANDT** *Ph.D., C.P.A.*

Arthur Andersen Alumni Professor of Accounting
University of Wisconsin
Madison, Wisconsin

► **DONALD E. KIESO** *Ph.D., C.P.A.*

KPMG Peat Marwick Emeritus Professor of Accountancy
Northern Illinois University
DeKalb, Illinois

► **WALTER G. KELL** *Ph.D., C.P.A.*

Professor Emeritus of Accounting
University of Michigan
Ann Arbor, Michigan



JOHN WILEY & SONS, INC.

New York • Chichester • Brisbane • Toronto • Singapore

ACQUISITIONS EDITOR Susan Elbe
SENIOR DEVELOPMENTAL EDITOR Nancy Perry
SENIOR MARKETING MANAGER Karen D. Allman
PRODUCTION COORDINATOR Elm Street Publishing Services, Inc.
DESIGNER Kevin Murphy
MANUFACTURING MANAGER Mark Cirillo
PHOTO EDITOR Mary Ann Price
PHOTO RESEARCHER Jennifer Atkins
ILLUSTRATION COORDINATOR Anna Melhorn
COVER PHOTO John Kelly/The Image Bank

This book was set in 10.5/12 Palatino by CRWaldman Graphic Communications, Inc. and printed and bound by Von Hoffmann Press. The cover was printed by Phoenix Color Corp.

Recognizing the importance of preserving what has been written, it is a policy of John Wiley & Sons, Inc. to have books of enduring value published in the United States printed on acid-free paper, and we exert our best efforts to that end.

The paper in this book was manufactured by a mill whose forest management programs include sustained yield harvesting of its timberlands. Sustained yield harvesting principles ensure that the number of trees cut each year does not exceed the amount of new growth. The specimen financial statements, Appendix A, are printed with permission of PepsiCo, Inc.

Copyright © 1996, by John Wiley & Sons, Inc.

All rights reserved. Published simultaneously in Canada.

Reproduction or translation of any part of this work beyond that permitted by Sections 107 and 108 of the 1976 United States Copyright Act without the permission of the copyright owner is unlawful. Requests for permission or further information should be addressed to the Permissions Department, John Wiley & Sons, Inc.

Library of Congress Cataloging-in-Publication Data

Weygandt, Jerry J.

Accounting principles / Jerry J. Weygandt, Donald E. Kieso, Walter G. Kell.—4th ed.

p. cm.

Includes index.

ISBN 0-471-03661-7 (cloth : alk. paper)

1. Accounting. I. Kieso, Donald E. II. Kell, Walter Gerry,

1921—

HF5635.W524 1995

657—dc20

95-38872

CIP

Printed in the United States of America

10 9 8 7 6 5



STUDENT **OWNER'S MANUAL**

STUDENT TO STUDENT

.....



HOW TO USE THE STUDY AIDS IN THIS BOOK

.....

The **Preview** starts with an introductory paragraph linking the vignette with the major topics of the chapter. It is followed by a graphic outline of major topics and subtopics that will be discussed. This narrative and visual preview gives you a mental framework upon which to arrange the new information you are learning.

Technology in Action sections, identified by a CD icon, show how computers are one of the most important tools to the accountant and users of accounting information.

Technology in Action



A malfunctioning computer software program doubled all withdrawals and transfers made at Chemical Bank automatic teller machines (ATMs) in New York state for about 12 hours. The printed record of transactions spit out by the ATM was accurate, but the computerized posting of the transactions was automatically doubled. The bank corrected all errors, which in the aggregate may have been \$15 million.

Source: *Demer Post*, February 19, 1994.

The incidence of errors depends on the effectiveness of the internal controls maintained by the depositor and the bank. Bank errors are infrequent. However, either party could inadvertently record a \$450 check as \$45 or \$540. In addition, the bank might mistakenly charge a check drawn by C. D. Berg to the account of C. D. Burg.

Reconciliation Procedure

To obtain maximum benefit from a bank reconciliation, the reconciliation should be prepared by an employee who has no other responsibilities pertaining to cash. When the internal control principle of independent internal verification is not followed in preparing the reconciliation, cash embezzlements may escape unnoticed. For example, a cashier who prepares the reconciliation can embezzle cash and conceal the embezzlement by misstating the reconciliation. Thus, the bank accounts would reconcile and the embezzlement would not be detected.

In reconciling the bank account, it is customary to reconcile the balance per books and balance per bank to their adjusted (correct or true) cash balances. The reconciliation schedule is divided into two sections, as shown in Illustration 7-12. The starting point in preparing the reconciliation is to enter the balance per bank statement and balance per books on the schedule. The following steps should reveal all the reconciling items that cause the difference between the two balances.

1. Compare the individual deposits on the bank statement with deposits in transit from the preceding bank reconciliation and with the deposits per company records or copies of duplicate deposit slips. Deposits recorded by the depositor that have not been recorded by the bank represent deposits in transit and are added to the balance per bank.
2. Compare the paid checks shown on the bank statement or the paid checks returned with the bank statement with (a) checks outstanding from the preceding bank reconciliation and (b) checks issued by the company as recorded in the cash payments journal. Issued checks recorded by the company that have not been paid by the bank represent outstanding checks that are deducted from the balance per the bank.
3. Note any errors discovered in the foregoing steps and list them in the appropriate section of the reconciliation schedule. For example, if a paid check correctly written by the company for \$195 was mistakenly recorded by the company for \$159, the error of \$36 is deducted from the balance per books. All errors made by the depositor are reconciling items in determining the adjusted cash balance per books. In contrast, all errors made by the bank are reconciling items in determining the adjusted cash balance per the bank.

Helpful hint: Deposits in transit and outstanding checks are reconciling items because of time lags.

st employees in the business that you own or manage? ever sometimes is Yes. For example, the financial press following:

small company diverted \$750,000 of bill payments to a nt over a 3-year period.

th 28 years of service shipped \$125,000 of merchandise

r embezzled \$21 million from Wells Fargo Bank over a

borrowed" \$150,000 of church funds to finance a friend's

size the need for a good system of internal control.

Helpful Hints in the margins help clarify concepts being discussed.

Key Terms and concepts are printed in blue where they are first explained in the text and are defined again in the end-of-chapter glossary.

Accounting in Action boxes give you more glimpses into the real world of accounting by discussing actual challenges faced by accountants. Each type of issue—business, ethics, and international—is identified by its own icon. Don't skip over the photos, figures, and tables.

with the depositor's name and address. Each check and with both a bank and a depositor identification number computer processing of the transaction.

Many companies have more than one bank account and better control, national retailers like Wal-Mart have regional bank accounts. Similarly, a company such as Exxon with more than 150,000 employees may have a payroll bank account, as well as one or more general bank accounts. In addition, a company may maintain several bank accounts in order to have more than one source for obtaining short-term loans when needed.

Making Bank Deposits

Bank deposits should be made by an authorized employee, such as the head cashier. Each deposit must be documented by a deposit slip (ticket), as shown in Illustration 7-9.

Deposit slips are prepared in duplicate. The original is retained by the bank; the duplicate, machine stamped by the bank to establish its authenticity, is retained by the depositor.

Color Illustrations visually reinforce important concepts and therefore often contain material that may appear on exams.

Infographics, a special type of illustration, pictorially link concepts to the real world.

Before You Go On Review It questions serve as a learning check. If you cannot answer these questions, you should go back and read the section again. Brief *Do It* exercises help you apply what you are learning; their solutions help you see how the problem should be solved. (Keyed to homework exercises.)

A petty cash fund should be replenished at the end of the accounting period regardless of the cash in the fund. Replenishment at this time is necessary in order to recognize the effects of the petty cash payments on the financial statements.

Internal control over a petty cash fund is strengthened by (1) having a supervisor make surprise counts of the fund to ascertain whether the paid vouchers and fund cash equal the imprest amount and (2) canceling or mutilating the paid vouchers so they cannot be resubmitted for reimbursement.

Before You Go On . . .

► Review It

1. How do the principles of internal control apply to cash receipts?
2. How do the principles of internal control apply to cash disbursements?
3. When are entries required in a petty cash system?

► Do It

L. R. Cortez is concerned about the control over cash receipts in his fast-food restaurant, Big Cheese. The restaurant has two cash registers. At no time do more than two employees take customer orders and ring up sales. Work shifts for employees range from 4 to 8 hours. Cortez asks your help in installing a good system of internal control over cash receipts.

Reasoning: Cortez needs to understand the principles of internal control, especially the principles of establishing responsibility, the use of electronic controls, and independent internal verification. Using this knowledge, an effective system of control over cash receipts can be designed and implemented.

Solution: Cortez should assign a cash register to each employee at the start of each work shift, with register totals set at zero. Each employee should be instructed to use only the assigned register and to ring up all sales. At the end of each work shift, Cortez or a supervisor / manager should total the register and make a cash count to see whether all cash is accounted for.

Related exercise material: BE7-3 and E7-2.

Use of a Bank

The use of a bank contributes significantly to good internal control over cash. A company can safeguard its cash by using a bank as a depository and clearing house for checks received and checks written. Use of a bank minimizes the amount of currency that must be kept on hand. In addition, the use of a bank facilitates the control of cash because a double record is maintained of all bank transactions—one by the business and the other by the bank. The asset account, Cash, maintained by the depositor is the reciprocal of the bank's liability account for each depositor. It should be possible to **reconcile these accounts** (make them agree) at any time.

Opening a bank checking account is a relatively simple procedure. Typically, the bank makes a credit check on the new customer and the depositor is required to sign a **signature card**. The card should contain the signatures of each person authorized to sign checks on the account. The signature card is used by bank employees to validate signatures on the checks.

As soon as possible after an account is opened, the bank will provide the depositor with a book of serially numbered checks and deposit slips imprinted

EASTMAN KODAK COMPANY

Current assets (in millions)
Cash and cash equivalents

Cash equivalents are highly liquid investments, with maturity less than three months, that can be converted into a specific amount of cash without risk of loss of principal. They include money market funds, money market savings certificates, and U.S. Treasury bills and notes.

A company may have cash that is restricted for a specific purpose, such as a payroll bank account for paying salaries and pension fund cash for financing new construction. If the restriction is to be used within the next year, the amount should be reported as a current asset. However, when this is not the case, the restricted funds are reported as a noncurrent asset. Since a payroll bank account will be used to pay payroll for employees, it is reported as a current asset. If the cash is to be used for new construction, it is reported as a noncurrent asset.

In making loans to depositors, it is common for banks to require the borrowers to maintain minimum cash balances. These minimum balances, called **compensating balances**, provide the bank with support for the loans. Compensating balances are a restriction on the use of cash that may affect a company's liquidity. Accordingly, compensating balances should be disclosed in the financial statements.

Before You Go On . . .

► Review It

1. What is generally reported as cash on a company's balance sheet?
2. What is meant by cash equivalents and compensating balances?

► A Look Back at Columbia University

Refer to the opening story about Columbia University, and answer the following questions:

1. Does Susan McLaughlin have a valid basis for establishing responsibility for overages or shortages? Why or why not?
2. What internal control principles are applicable to reconciling cash register tapes and the amount of cash in the cash drawer at the end of the day?
3. What internal control principle is involved in seeing that a student gets a receipt when buying a meal at a register? How does this requirement contribute to good internal control?
4. Do you think the cashiers are, or should be, bonded?

Solution

1. Establishing responsibility for overages or shortages is made only at the end of the day. This will provide a valid basis for evaluation only if one person worked the register for the entire day. If more than one person works the register during the day, the single count will not provide a valid basis for establishing who is responsible for the overage or shortage.
2. Applicable internal control principles are: (a) Segregation of duties—the cashier(s) should not be involved in performing the reconciliation. (b) Documentation procedure.

STUDY OBJECTIVE

Indicate the control features of a bank account.

The last **Before You Go On** exercise takes you back for a critical look at the chapter-opening vignette.

Under the Foreign Corrupt Practices Act of 1977, all major U.S. corporations are required to maintain an adequate system of internal control. Companies that fail to comply are subject to fines, and company officers may be imprisoned. Also, the National Commission on Fraudulent Financial Reporting concluded that all companies whose stock is publicly traded should maintain internal controls that can provide reasonable assurance that fraudulent financial reporting will be prevented or subject to early detection.¹

Principles of Internal Control

To safeguard its assets and enhance the accuracy and reliability of its accounting records, a company follows specific control principles. Of course, internal control measures vary with the size and nature of the business and with management's control philosophy. However, the six principles listed in Illustration 7-1 apply to most enterprises:

► International note

U.S. companies also adopt model business codes that guide their international operations to provide for a safe and healthy workplace, avoid child and forced labor, abstain from bribes, and follow sound environmental practices.

International Notes provide a helpful way of introducing international issues and problems in accounting.

Study Objectives reappear in the margins at each point that the topic is discussed. End-of-chapter exercises and problems are keyed to study objectives.

► Ethics note

Fundamental to internal control systems is the assumption that employees are honest and ethical and will not commit wrongdoing. As a result, most control measures are more effective in preventing and detecting errors than irregularities.

Ethics Notes help sensitize you to the real-world ethical dilemmas of accounting.

¹Report of the National Commission on Fraudulent Financial Reporting, October 1987, p. 11.

The **Summary of Study Objectives** relates the chapter summary to the study objectives located throughout the chapter. It gives you another opportunity to review as well as to see how all the key topics within the chapter are related.

Summary of Study Objectives

1. **Define internal control.** Internal control is the plan of organization and related methods and procedures adopted within a business to safeguard its assets and to enhance the accuracy and reliability of its accounting records.
2. **Identify the principles of internal control.** The principles of internal control are: establishment of responsibility; segregation of duties; documentation procedures; physical, mechanical, and electronic controls; independent internal verification; and other controls.
3. **Explain the applications of internal control principles to cash receipts.** Internal controls over cash receipts include: (a) designating only personnel such as cashiers to handle cash; (b) assigning the duties of receiving cash, recording cash, and custody of cash to different individuals; (c) obtaining remittance advices for mail receipts, cash register tapes for over-the-counter receipts, and deposit slips for bank deposits; (d) using company safes and bank vaults to store cash with access limited to authorized personnel, and using cash registers in executing over-the-counter receipts; (e) making independent daily counts of register receipts and daily comparisons of total receipts with total deposits; and (f) bonding personnel that handle cash and requiring them to take vacations.
4. **Describe the applications of internal control principles to cash disbursements.** Internal controls over cash disbursements include: (a) having only specified individuals such as the treasurer authorized to sign checks; (b) assigning the duties of approving items for payment, paying the items, and recording the payment to different individuals; (c) using

prenumbered checks and accounting for all checks, with each check supported by an approved invoice; (d) storing blank checks in a safe or vault with access restricted to authorized personnel, and using a checkwriter to imprint amounts on checks; (e) comparing each check with the approved invoice before issuing the check, and making monthly reconciliations of bank and book balances; and (f) after payment, stamping each approved invoice "paid."

5. **Explain the operation of a petty cash fund.** In operating a petty cash fund, it is necessary to establish the fund, make payments from the fund, and replenish the fund.

6. **Indicate the control features of a bank account.** A bank account contributes to good internal control by providing physical controls for the storage of cash, minimizing the amount of currency that must be kept on hand, and creating a double record of a depositor's bank transactions.

7. **Prepare a bank reconciliation.** In reconciling the bank account, it is customary to reconcile the balance per books and balance per bank to their adjusted balances. The steps in determining the reconciling items are to ascertain deposits in transit, outstanding checks, errors by the depositor or the bank, and unrecorded bank memoranda.

8. **Explain the reporting of cash.** Cash is listed first in the current assets section of the balance sheet. In some cases, cash is reported together with cash equivalents. Cash restricted for a special purpose is reported separately as a current asset or as a noncurrent asset depending on when the cash is expected to be used.

The **Glossary** defines all the terms and concepts introduced in the chapter.

Glossary

Bank service charge A fee charged by a bank for the use of its services. (p. 301).

Bank statement A statement received monthly from the bank that shows the depositor's bank transactions and balances. (p. 300).

Cash Resources that consist of coins, currency, checks, money orders, and money on hand or on deposit in a bank or similar depository. (p. 291).

Cash equivalents Highly liquid investments, with matur-

Questions allow you to explain your understanding of concepts and relationships covered in the chapter.

QUESTIONS

1. "Internal control is concerned only with enhancing the accuracy of the accounting records." Do you agree? Explain.
2. What principles of internal control apply to most business enterprises?
3. In the corner grocery store, all sales clerks make change out of one cash register drawer. Is this a violation of internal control? Why?
4. J. Duma is reviewing the principle of segregation of duties. What are the two common applications of this principle?
5. How do documentation procedures contribute to good internal control?
6. What internal control objectives are met by physical, mechanical, and electronic controls?
7. (a) Explain the control principle of independent internal verification. (b) What practices are important in applying this principle?
8. The management of Cobo Company asks you, as the company accountant, to explain (a) the concept of reasonable assurance in internal control and (b) the importance of the human factor in internal control.
9. Midwest Inc. owns the following assets at the balance sheet date:

Cash in bank-savings account	\$ 5,000
Cash on hand	850
Cash refund due from the IRS	1,000
Checking account balance	12,000
Postdated checks	500

 What amount should be reported as cash in the balance sheet?
10. What principle(s) of internal control is (are) involved in making daily cash counts of over-the-counter receipts?
11. Dent Department Stores has just installed new electronic cash registers in its stores. How do cash registers improve internal control over cash receipts?
12. In Allen Wholesale Company, two mail clerks open all mail receipts. How does this strengthen internal control?
13. "To have maximum effective internal control over cash disbursements, all payments should be made by check." Is this true? Explain.
14. Handy Company's internal controls over cash disbursements provide for the treasurer to sign checks imprinted by a checkwriter after comparing the check with the approved invoice. Identify the internal control principles that are present in these controls.
15. How do the principles of (a) physical, mechanical, and electronic controls and (b) other controls apply to cash disbursements?
16. (a) What is a voucher system? (b) What principles of internal control apply to a voucher system?
17. What is the essential feature of an electronic funds transfer (EFT) procedure?
18. (a) Identify the three activities that pertain to a petty cash fund, and indicate an internal control principle that is applicable to each activity. (b) When are journal entries required in the operation of a petty cash fund?
19. "The use of a bank contributes significantly to good internal control over cash." Is this true? Why?
20. Paul Pascal is confused about the lack of agreement between the cash balance per books and the balance per the bank. Explain the causes for the lack of agreement to Paul, and give an example of each cause.
21. What are the four steps involved in finding differences between the balance per books and balance per banks?
22. Mary More asks your help concerning an NSF check. Explain to Mary (a) what an NSF check is, (b) how it is treated in a bank reconciliation, and (c) whether it will require an adjusting entry per bank.
23. (a) "Cash equivalents are the same as cash." Do you agree? Explain. (b) How should restricted cash funds be reported on the balance sheet?

Brief Exercises help you focus on one Study Objective at a time and thus help you build confidence in your basic skills and knowledge. (Keyed to Study Objectives.)

BRIEF EXERCISES

- BE7-1** Gina Milan is the new owner of Liberty Parking. She has heard about internal control but is not clear about its importance for her business. Explain to Gina the two purposes of internal control and give her one application of each purpose for Liberty Parking. *Explain the importance of internal control. (SO 1).*
- BE7-2** The internal control procedures in Marion Company provide that:
 (a) Employees who have physical custody of assets do not have access to the accounting records. *Identify internal control principles. (SO 2).*

EXERCISES


Identify the principles of internal control. (SO 2).

E7-1 Joe Marino is the owner of Marino's Pizza. Marino's is operated strictly on a carryout basis. Customers pick up their orders at a counter where a clerk exchanges the pizza for cash. While at the counter, the customer can see other employees making the pizzas and the large ovens in which the pizzas are baked.


Instructions

Identify the six principles of internal control and give an example of each principle that you might observe when picking up your pizza. (Note: It may not be possible to observe all the principles.)

Exercises, which gradually increase in skills, understanding, and time necessary to complete them, help you continue to build your confidence. (Keyed to Study Objectives.)

Certain exercises or problems marked with an icon  help you practice business writing skills.

Instructions

- List the weaknesses in internal control over cash disbursements.
-  Write a memo to your boss indicating your recommendations for improvement.

E7-5 Ramona Company uses an imprest petty cash system. The fund was established on March 1 with a balance of \$100. During March the following petty cash receipts were found in the petty cash box:

Prepare journal entries for a petty cash fund. (SO 5).

Date	Receipt No.	For	Amount
3/5	1	Stamp Inventory	\$38
7	2	Freight-in	19
9	3	Miscellaneous Expense	12
11	4	Travel Expense	24
14	5	Miscellaneous Expense	5

There was no cash over or short. The fund was replenished on March 15. On March 20, the amount in the fund was increased to \$150.

Instructions

- Prepare the bank reconciliation at September 30.
- Prepare the adjusting entries at September 30, assuming (1) the NSF check was from a customer on account, and (2) no interest had been accrued on the note.

E7-10 The cash records of Kuwait Company show the following:

- The June 30 bank reconciliation indicated that deposits in transit total \$850. During July the general ledger account Cash shows deposits of \$15,750, but the bank statement indicates that only \$15,600 in deposits were received during the month.
- The June 30 bank reconciliation also reported outstanding checks of \$920. During the month of July, Kuwait Company books show that \$17,200 of checks were issued, yet the bank statement showed that \$16,400 of checks cleared the bank in July.
- In September, deposits per the bank statement totaled \$26,700, deposits per books were \$25,400, and deposits in transit at September 30 were \$2,400.
- In September, cash disbursements per books were \$23,700, checks clearing the bank were \$25,000, and outstanding checks at September 30 were \$2,100.

There were no bank debit or credit memoranda, and no errors were made by either the bank or Kuwait Company.

Compute deposits in transit and outstanding checks for two bank reconciliations. (SO 7).

Instructions

Answer the following questions:

- In situation (1), what were the deposits in transit at July 31?
- In situation (2), what were the outstanding checks at July 31?
- In situation (3), what were the deposits in transit at August 31?
- In situation (4), what were the outstanding checks at August 31?

PROBLEMS

P7-1 Red River Theater is located in the Red River Mall. A cashier's booth is located near the entrance to the theater. Two cashiers are employed. One works from 1-5 P.M., the other from 5-9 P.M. Each cashier is bonded. The cashiers receive cash from customers and operate a machine that ejects serially numbered tickets. The rolls of tickets are inserted and locked into the machine by the theater manager at the beginning of each cashier's shift.

After purchasing a ticket, the customer takes the ticket to a doorperson stationed at the entrance of the theater lobby some 60 feet from the cashier's booth. The doorperson tears the ticket in half, admits the customer, and returns the ticket stub to the customer. The other half of the ticket is dropped into a locked box by the doorperson.

At the end of each cashier's shift, the theater manager removes the ticket rolls from the machine and makes a cash count. The cash count sheet is initialed by the cashier. At the end of the day, the manager deposits the receipts in total in a bank night deposit vault located in the mall. In addition, the manager sends copies of the deposit slip and the initialed cash count sheets to the theater company treasurer for verification and to the company's accounting department. Receipts from the first shift are stored in a safe located in the manager's office.

Instructions

- Identify the internal control principles and their application to the cash receipts transactions of the Red River Theater.
- If the doorperson and cashier decide to collaborate to misappropriate cash, what actions might they take?

Identify internal control weaknesses over cash receipts. (SO 2, 3).


P7-2 MTR Company maintains a petty cash fund for small expenditures. The following transactions occurred over a 2-month period:

- Established petty cash fund by writing a check on Metro Bank for \$200.
- Replenished the petty cash fund by writing a check for \$194.30. On this date the fund consisted of \$5.70 in cash and the following petty cash receipts: Freight-in \$94.00, postage expense \$42.40, entertainment expense \$46.60, and miscellaneous expense \$10.70.
- Replenished the petty cash fund by writing a check for \$192.00. At this date, the fund consisted of \$8.00 in cash and the following petty cash receipts: Freight-in

Journalize and post petty cash fund transactions. (SO 5).

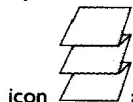
Each **Problem** helps you pull together and apply several concepts of the chapter. Included in these are problems that help you develop the writing skills that are so important in business. (Keyed to multiple Study Objectives.)


General Ledger Problems, identified by

an icon  are selected problems that can be solved using the General Ledger Software package.

Paired with the Problems, **Alternate Problems** provide additional opportunities to apply concepts learned in the chapter. (Each Alternate Problem is keyed to the same Study Objectives as its counterpart in the Problems set.)

Spreadsheet Problems identified by an



icon  are selected exercises and problems that can be solved using *Solving Principles of Accounting Problems Using Lotus 1-2-3 or Excel*.

Prepare correct multiple-step and single-step income statements. (SO 5, 7).



P5-5A A part-time bookkeeper prepared the following income statement for the Tao Company for the year ending December 31, 1996.

**TAO COMPANY
Income Statement
December 31, 1996**

Revenues		
Sales		\$702,000
Less: Freight-in	\$ 17,200	
Discounts	4,100	21,300
Net sales		680,700
Other revenues (net)		1,300
Total revenues		682,000
Expenses		
Purchases	470,000	
Selling expenses	100,000	
Administrative expenses	50,000	
L. Tao, Drawings	12,000	
Total expenses		632,000
Net income		\$ 50,000

As an experienced, knowledgeable accountant you review the statement and determine the following facts:

- Sales includes \$10,000 of deposits from customers for future sales orders.
- Discounts consist of purchase discounts earned \$7,200 and sales discounts granted \$11,300.
- Other revenues contains two items: interest expense \$4,000 and interest revenue \$5,300.
- Purchases includes freight-out \$14,000 less purchase returns and allowances \$9,000.
- Ending merchandise inventory increased \$20,000 from a beginning inventory of \$35,000.
- Selling expenses consist of sales salaries \$76,000, advertising \$10,000, depreciation on store equipment \$7,500, and sales commissions expense \$6,500.
- Administrative expenses consist of office salaries \$19,000, utilities expense \$8,000, rent expense \$16,000, and insurance expense \$7,000. Insurance expense includes \$1,200 of insurance applicable to 1994.

► Broadening Your Perspective

c FINANCIAL REPORTING PROBLEM

The financial statements of PepsiCo, Inc. are presented in Appendix A of this textbook together with two reports: (1) a management report, Management's Responsibility for Financial Statements, and (2) an auditor's report, Report of Independent Auditors.

Instructions

Using the financial statements and reports, answer the following questions about PepsiCo's internal controls and cash.

1. What comments, if any, concerning the company's system of internal control are included in each report?
2. What reference, if any, is made to internal auditors in each report?
3. What comments, if any, are made about cash in the report of the independent auditors?
4. What data about cash and cash equivalents are shown in the consolidated balance sheet (statement of financial condition)?
5. What activities are identified in the consolidated statement of cash flows as being responsible for the changes in cash during 1994?
6. How are cash equivalents defined under the Notes to Consolidated Financial Statements?

e DECISION CASE

The board of trustees of a local church is concerned about the internal accounting controls pertaining to the offering collections made at weekly services. They ask you to serve on a three-person audit team with the internal auditor of the university and a CPA who has just joined the church.

At a meeting of the audit team and the board of trustees you learn the following:

1. The church's board of trustees has delegated responsibility for the financial management and audit of the financial records to the finance committee. This group prepares the annual budget and approves major disbursements but is not involved in collections or record keeping. No audit has been made in recent years because the same trusted employee has kept church records and served as financial secretary for 15 years. The church does not carry any fidelity insurance.
2. The collection at the weekly service is taken by a team of ushers who volunteer to serve one month. The ushers take the collection plates to a basement office at the rear of the church. They hand their plates to the head usher and return to the church service. After all plates have been turned in, the head usher counts the cash received. The head usher then places the cash in the church safe along with a notation of the amount counted. The head usher volunteers to serve for 3 months.
3. The next morning the financial secretary opens the safe and recounts the collection. The secretary withholds \$150–\$200 in cash, depending on the cash expenditures expected for the week, and deposits the remainder of the collections in the bank. To facilitate the deposit, church members who contribute by check are asked to make their checks payable to "cash."
4. Each month, the financial secretary reconciles the bank statement and submits a copy of the reconciliation to the board of trustees. The reconciliations have rarely contained any bank errors and have never shown any errors per books.

Instructions

- (a) Indicate the weaknesses in internal accounting control over the handling of collections.

The **Broadening Your Perspective** section helps you pull together various concepts covered in the chapter and apply them to real-life business decisions.

A **Financial Reporting Case** familiarizes you with the format, content, and uses of financial statements prepared by major U.S. companies.

A **Decision Case** helps you build your decision-making skills by analyzing accounting information in a less structured situation. At the same time it provides practice in your writing skills.

Communication Activities ask you to engage in real-life business situations using your writing, speaking, or presentation skills.

Group Activities prepare you for the business world, where you will be working with many people, by giving you practice in solving problems with colleagues.

- (b) List the improvements in internal control procedures that you plan to make at the next meeting of the audit team for (1) the ushers, (2) the head usher, (3) the financial secretary, and (4) the finance committee.
- (c) What church policies should be changed to improve internal control?

COMMUNICATION ACTIVITY

As a new auditor for the CPA firm of Rawls, Keoto, and Landry you have been assigned to review the internal controls over mail cash receipts of Adirondack Company. Your review reveals the following: Checks are promptly endorsed "For Deposit Only," but no list of the checks is prepared by the person opening the mail. The mail is opened either by the cashier or by the employee who maintains the accounts receivable records. Mail receipts are deposited in the bank weekly by the cashier.

Instructions

Write a letter to L. S. Osman, owner of the Adirondack Company, explaining the weaknesses in internal control and your recommendations for improving the system.

GROUP ACTIVITY

From your employment or personal experiences, identify situations in which cash was received or disbursed.

Instructions

In groups of five or six students:

- (a) Identify the internal control principles used for cash receipts.
- (b) Identify the internal control principles used for cash disbursements.
- (c) Identify any weaknesses in internal control related to cash receipts and disbursements.

E

AN

Through the **Ethics Cases** you will reflect on ethical situations an accountant typically confronts.

ETHICS CASE

You are the assistant controller in charge of general ledger accounting at Lemon Twist Bottling Company. Your company has a large loan from an insurance company. The loan agreement requires that the company's cash account balance be maintained at \$200,000 or more as reported monthly. At June 30 the cash balance is \$80,000, which you report to Sam Williams, the financial vice-president. Sam excitedly instructs you to keep the cash receipts book open for one additional day for purposes of the June 30 report to the insurance company. Sam says, "If we don't get that cash balance over \$200,000, we'll default on our loan agreement. They could close us down, put us all out of our jobs!" Sam continues, "I talked to Grochum Distributors (one of Lemon Twist's largest customers) this morning and they said they sent us a check for \$150,000 yesterday. We should receive it tomorrow. If we include just that one check in our cash balance, we'll be in the clear. It's in the mail!"

Instructions

- Who will suffer negative effects if you do not comply with Sam Williams' instructions? Who will suffer if you do comply?
- What are the ethical considerations in this case?
- What alternatives do you have?

CRITICAL THINKING CASE

► A Real-World Focus: Alternative Distributor Corp.

Alternative Distributor Corp., a distributor of groceries and related products, is headquartered in Medford, Massachusetts. It was founded in 1980 and today has seven employees, with a total sales of \$7 million.

During its audit, the Alternative Distributor Corp. was advised that previously existing internal controls necessary for the company to develop reliable financial statements were inadequate. The audit report stated that the current system of accounting for sales, receivables, and cash receipts constituted a material weakness.

Among other items, the report focused on non-timely deposit of cash receipts, exposing Alternative Distributor to potential loss or misappropriation; excessive past due accounts receivable due to lack of collection efforts; disregard of advantages offered by vendors for prompt payment of invoices; absence of appropriate segregation of duties by personnel consistent with appropriate control objectives; inadequate procedures for applying accounting principles; lack of qualified management personnel; lack of supervision by an outside board of directors; and overall poor recordkeeping.

Instructions

Identify the principles of internal control violated by Alternative Distributor Corporation.

Answers to Self-Study Questions

1. a 2. c 3. b 4. c 5. b 6. d 7. a 8. a 9. c 10. d 11. c

Critical Thinking: A Real-World Focus asks you to decide how to apply the concepts you have learned to specific situations faced by actual companies.

Answers to Self-Study Questions provide feedback on your understanding of concepts.

HOW DO YOU LEARN BEST?

.....

Now that you have looked at your Owner's Manual, take time to find out how you learn best. This quiz was designed to help you find out something about your preferred learning method. Research on left brain/right brain differences and also on learning and personality differences suggests that each person has preferred ways to receive and communicate information. After taking the

.....

quiz, we will help you pinpoint the study aids in this text that will help you learn the material based on your learning style.



Circle the letter of the answer that best explains your preference. If a single answer does not match your perception, please circle two or more choices. Leave blank any question that does not apply.



.....

1. You are about to give directions to a person. She is staying in a hotel in town and wants to visit your house. She has a rental car. Would you
V) draw a map on paper?
R) write down the directions (without a map)?
A) tell her the directions?
K) pick her up at the hotel in your car?
2. You are staying in a hotel and have a rental car. You would like to visit friends whose address/location you do not know. Would you like them to
V) draw you a map on paper?
R) write down the directions (without a map)?
A) tell you the directions by phone?
K) pick you up at the hotel in their car?
3. You have just received a copy of your itinerary for a world trip. This is of interest to a friend. Would you
A) call her immediately and tell her about it?
R) send her a copy of the printed itinerary?
V) show her on a map of the world?
4. You are going to cook a dessert as a special treat for your family. Do you
K) cook something familiar without need for instructions?
V) thumb through the cookbook looking for ideas from the pictures?
R) refer to a specific cookbook where there is a good recipe?
A) ask for advice from others?
5. A group of tourists has been assigned to you to find out about national parks. Would you
K) drive them to a national park?
R) give them a book on national parks?
V) show them slides and photographs?
A) give them a talk on national parks?
6. You are about to purchase a new stereo. Other than price, what would most influence your decision?
A) A friend talking about it.
K) Listening to it.
R) Reading the details about it.
V) Its distinctive, upscale appearance.
7. Recall a time in your life when you learned how to do something like playing a new board game. (Try to avoid choosing a very physical skill, e.g., riding a bike.) How did you learn best? By
V) visual clues—pictures, diagrams, charts?
A) listening to somebody explaining it?
R) written instructions?
K) doing it?
8. Which of these games do you prefer?
V) *Pictionary*
R) *Scrabble*
K) Charades
9. You are about to learn to use a new program on a computer. Would you
K) ask a friend to show you?
R) read the manual that comes with the program?
A) telephone a friend and ask questions about it?
10. You are not sure whether a word should be spelled "dependent" or "dependant." Do you
R) look it up in the dictionary?
V) see the word in your mind and choose the best way it looks?
A) sound it out in your mind?
K) write both versions down?
11. Apart from price, what would most influence your decision to buy a particular textbook?
K) Using a friend's copy.
R) Skimming parts of it.
A) A friend talking about it.
V) It looks OK.
12. A new movie has arrived in town. What would most influence your decision to go or not to go?
A) Friends talked about it.
R) You read a review of it.
V) You saw a preview of it.
13. Do you prefer a lecturer/teacher who likes to use
R) handouts and/or a textbook?
V) flow diagrams, charts, slides?
K) field trips, labs, practical sessions?
A) discussion, guest speakers?


Results: To determine your learning preference, add up the number of individual Vs, As, Rs, and Ks you have circled. Take the letter you have the greatest number of and match it to the same letter in the Learning Styles Chart. Next to each letter in the Chart are suggestions that will refer you to different learning aids throughout this text.


LEARNING STYLES CHART

TYPE	WHAT TO DO IN CLASS	WHAT TO DO WHEN STUDYING	TEXT FEATURES THAT MAY HELP YOU THE MOST	WHAT TO DO PRIOR TO AND DURING EXAMS
 VISUAL 	Underline. Use different colors. Use symbols, charts, arrangements on the page.	Use the "In Class" strategies. Reconstruct images in different ways. Redraw pages from memory. Replace words with symbols and initials.	Preview Infographics/ Illustrations Photos Accounting in Action Technology in Action Key Terms in blue Words in bold Questions/Exercises/ Problems Financial Reporting Problem	Recall the "pictures of the pages." Draw, use diagrams where appropriate. Practice turning visuals back into words.

TYPE	WHAT TO DO IN CLASS	WHAT TO DO WHEN STUDYING	TEXT FEATURES THAT MAY HELP YOU THE MOST	WHAT TO DO PRIOR TO AND DURING EXAMS
 AURAL 	Attend lectures and tutorials. Discuss topics with students. Explain new ideas to other people. Use a tape recorder. Describe overheads, pictures, and visuals to somebody not there. Leave space in your notes for later recall.	You may take poor notes because you prefer to listen. Therefore: Expand your notes. Put summarized notes on tape and listen. Read summarized notes out loud. Explain notes to another "aural" person.	Infographics/Illustrations Accounting in Action Technology in Action Review It/Do It Summary of Study Objectives Glossary Demonstration Problem Self-Study Questions Questions/Exercises/ Problems Financial Reporting Problem Decision Case Communication Activity Group Activity Ethics Case Critical Thinking Videos	Listen to your "voices" and write them down. Speak your answers. Practice writing answers to old exam questions.

Source: Adapted from Neil D. Fleming and Colleen Mills, "Not Another Inventory, Rather a Catalyst for Reflections," *To Improve the Academy*, Volume II (1992), pp. 137-155. Used by permission.

TYPE	WHAT TO DO IN CLASS	WHAT TO DO WHEN STUDYING	TEXT FEATURES THAT MAY HELP YOU THE MOST	WHAT TO DO PRIOR TO AND DURING EXAMS
R READING/WRITING 	Use lists, headings. Use dictionaries and definitions. Use handouts and textbooks. Read. Use lecture notes.	Write out words again and again. Reread notes silently. Rewrite ideas into other words. Organize diagrams into statements.	Study Objectives Preview Review It/Do It Summary of Study Objectives Glossary Self-Study Questions Questions/Exercises/Problems Writing Problems Financial Reporting Problem Decision Case Communication Activity Group Activity Ethics Case Critical Thinking	Practice with multiple-choice questions. Write out lists. Write paragraphs, beginnings and endings.

TYPE	WHAT TO DO IN CLASS	WHAT TO DO WHEN STUDYING	TEXT FEATURES THAT MAY HELP YOU THE MOST	WHAT TO DO PRIOR TO AND DURING EXAMS
K KINESTHETIC 	Use all your senses. Go to labs, take field trips. Use trial-and-error methods. Listen to real-life examples. Use hands-on approach.	You may take notes poorly because topics do not seem relevant. Therefore: Put examples in note summaries. Use pictures and photos to illustrate. Talk about notes with another "kinesthetic" person.	Concepts for Review Vignettes Preview Infographics/Illustrations Review It/Do It A Look Back at . . . Summary of Study Objectives Demonstration Problem Self-Study Questions Questions/Exercises/Problems Financial Reporting Problem Decision Case Communication Activity Group Activity	Write practice answers. Role-play the exam situation.