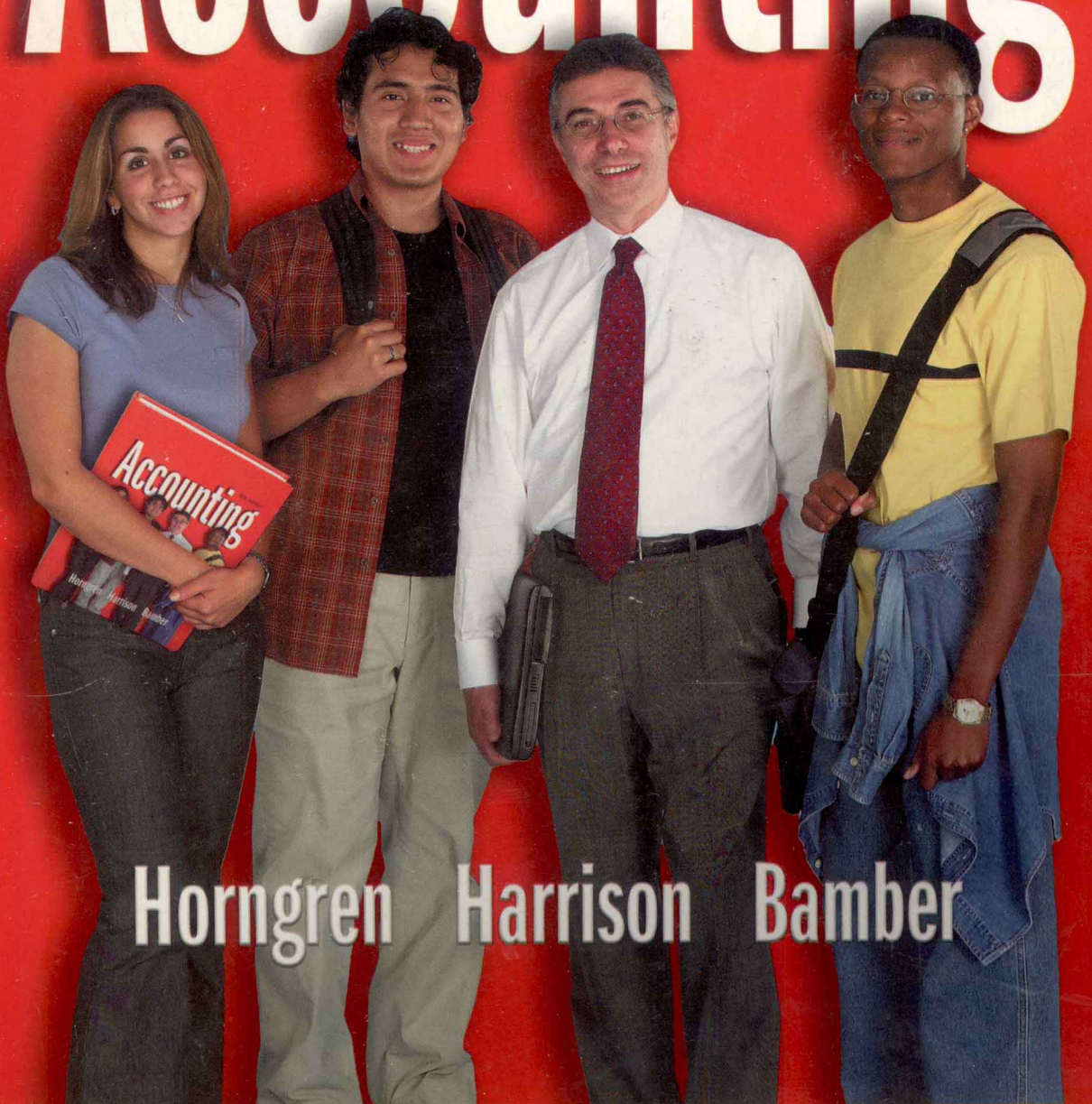


INTERNATIONAL EDITION

6th edition

Accounting



Horngren Harrison Bamber

To Betsy Willis and Becky Jones for their wisdom on learning and teaching over a 15-year period and to Michael Bamber for his insight on business practices and ethical issues in management accounting.

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Charles T. Horngren is the Edmund W. Littlefield Professor of Accounting, Emeritus, at Stanford University. A graduate of Marquette University, he received his MBA from Harvard University and his Ph.D. from the University of Chicago. He is also the recipient of honorary doctorates from Marquette University and DePaul University.

A Certified Public Accountant, Horngren served on the Accounting Principles Board for six years, the Financial Accounting Standards Board Advisory Council for five years, and the Council of the American Institute of Certified Public Accountants for three years. For six years, he served as a trustee of the Financial Accounting Foundation, which oversees the Financial Accounting Standards Board and the Government Accounting Standards Board.

Horngren is a member of the Accounting Hall of Fame.

A member of the American Accounting Association, Horngren has been its President and its Director of Research. He received its first annual Outstanding Accounting Educator Award.

The California Certified Public Accountants Foundation gave Horngren its Faculty Excellence Award and its Distinguished Professor Award. He is the first person to have received both awards.

The American Institute of Certified Public Accountants presented its first Outstanding Educator Award to Horngren.

Horngren was named Accountant of the Year, Education, by the national professional accounting fraternity, Beta Alpha Psi.

Professor Horngren is also a member of the Institute of Management Accountants, from whom he has received its Distinguished Service Award. He was a member of the Institute's Board of Regents, which administers the Certified Management Accountant examinations.

Horngren is the author of other accounting books published by Prentice-Hall: *Cost Accounting: A Managerial Emphasis*, Eleventh Edition, 2003 (with Srikant Datar and George Foster); *Introduction to Financial Accounting*, Eighth Edition, 2002 (with Gary L. Sundem and John A. Elliott); *Introduction to Management Accounting*, Thirteenth Edition, 2005 (with Gary L. Sundem and William Stratton); *Financial Accounting*, Fifth Edition, 2004 (with Walter T. Harrison, Jr.).

Horngren is the Consulting Editor for Prentice-Hall's Charles T. Horngren Series in Accounting.



Walter T. Harrison, Jr. is Professor of Accounting at the Hankamer School of Business, Baylor University. He received his B.B.A. degree from Baylor University, his M.S. from Oklahoma State University, and his Ph.D. from Michigan State University.

Professor Harrison, recipient of numerous teaching awards from student groups as well as from university administrators, has also taught at Cleveland State Community College, Michigan State University, the University of Texas, and Stanford University.

A member of the American Accounting Association and the American Institute of Certified Public Accountants, Professor Harrison has served as Chairman of the Financial Accounting Standards Committee of the American Accounting Association, on the Teaching/Curriculum Development Award Committee, on the Program Advisory Committee for Accounting Education and Teaching, and on the Notable Contributions to Accounting Literature Committee.



Professor Harrison has lectured in several foreign countries and published articles in numerous journals, including *The Accounting Review*, *Journal of Accounting Research*, *Journal of Accountancy*, *Journal of Accounting and Public Policy*, *Economic Consequences of Financial Accounting Standards*, *Accounting Horizons*, *Issues in Accounting Education*, and *Journal of Law and Commerce*.

He is co-author of *Financial Accounting*, Fifth Edition, 2004 (with Charles T. Horngren), published by Prentice Hall. Professor Harrison has received scholarships, fellowships, and research grants or awards from PriceWaterhouse Coopers, Deloitte & Touche, the Ernst & Young Foundation, and the KPMG Foundation.



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Professor Bamber has received numerous teaching awards from The Ohio State University, the University of Florida, and the University of Georgia.

She has lectured in Canada and Australia, in addition to the U.S., and her research has appeared in numerous journals, including *The Accounting Review*, *Journal of Accounting Research*, *Journal of Accounting and Economics*, *Journal of Finance*, *Contemporary Accounting Research*, *Accounting Horizons*, *Issues in Accounting Education*, and *The CPA Journal*. She also developed the annotations for the *Annotated Instructor's Edition* of Horngren, Foster, and Datar's *Cost Accounting: A Managerial Emphasis*, Seventh, Eighth, and Ninth Editions.

A member of the Institute of Management Accounting, the American Accounting Association (AAA) and the AAA's Management Accounting Section and Financial Accounting and Reporting Section, Professor Bamber has chaired the AAA New Faculty Consortium and the AAA Competitive Manuscript Award Committees, served on the AAA Council, the AAA Research Advisory Committee, the AAA Nominations Committee, and numerous other AAA and section committees. She served as Associate Editor of *Accounting Horizons*, and as editor of *The Accounting Review*.

Preface

From The Authors

This new sixth edition of *Accounting* has been tailored to meet instructors' needs and to help students master accounting. We think our efforts have made this revision much easier for instructors to teach and students to learn from. Throughout the text, we have streamlined the presentation and focused the content on the core topics of first-year accounting. To better prepare students for the business world, wherever possible we have used actual documents and real situations.

The text revisions and the new design, combined with an outstanding resource package, provide excellent tools for success in accounting. We hope you agree.

Charles Horngren



Tom Harrison



Linda Bamber



New! A+ Tips leads you to all the learning resources that accompany the text. Follow the A+ Tips to improve your understanding—and your course grade!

Learning Objectives give you an overview of the skills you will learn in the chapter.

Chapter-opening vignettes take you into the real world of accounting—where business decisions affect the future of actual organizations. Each vignette introduces you to the central issues covered in the chapter. Many of the vignettes—on Jelly Belly, Oracle, Dell—are linked to unique, custom-created *On Location! Videos* available on the **Student and Instructor Resource CD-ROMs**.

New feature company:
Amazon.com Amazon.com's annual report is bound into the book; Amazon is also the feature company in several chapter-opening vignettes, and in end-of-chapter financial statement cases.

Features

New! Sitemaps appear at the beginning of each chapter and at main headings throughout the chapter as a roadmap to show you where you are and what is coming next.

184 Chapter 5

Sitemap

- Merchandising Operations
- Accounting for Inventory: Perpetual System
- Adjusting and Closing Accounts
- Preparing Financial Statements
- Key Decision-Making Ratios

We shift gears in Chapter 5. The first four chapters focused on service companies such as *Gay Gillen eTravel*, the *San Francisco Giants*, and *eBay*. Here we begin working with merchandisers such as *Amazon.com*, *Target*, and *Circuit City*. A merchandiser differs from a service business in two important ways. A merchandiser sells products, whereas a service company provides a service. A merchandiser has an asset called *merchandise inventory*, such as DVDs, videos, and clothing. A service company carries no inventory.

Inventory includes all the goods a company owns and holds for sale in the normal course of operations. Throughout the remainder of the book we refer to merchandise inventory simply as inventory. It is a merchandiser's most important asset. This chapter demonstrates the central role of inventory in a business that sells merchandise. We illustrate accounting for the purchase and sale of inventory, and we also illustrate how to adjust and

What Are Merchandising Operations?

Merchandising is the business activity of buying and selling products rather than services. Accounting for merchandising operations requires us to deal with these balance sheet and income statement items.

Balance Sheet:

- Inventory, an asset

Income Statement:

- Sales revenue (often abbreviated as Sales), a revenue
- Cost of goods sold, an expense

These items are italicized in Exhibit 5-1 for Merchandising Co. Let's begin with the operating cycle of a merchandising business.

Merchandising Operations

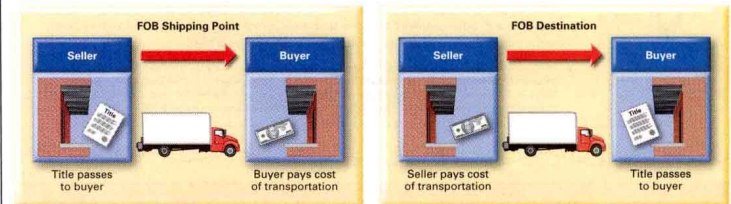
- └ Accounting for Inventory: Perpetual System
- └ Adjusting and Closing Accounts
- └ Preparing Financial Statements
- └ Key Decision-Making Ratios

Student Resource CD
periodic system, perpetual system

New! An open and reader-friendly text design includes many new exhibits and infographics.

TRANSPORTATION COSTS The transportation cost of moving inventory from seller to buyer can be significant. The purchase agreement specifies FOB terms to indicate who pays the shipping charges. *FOB* means *free on board*. FOB terms govern (1) when legal title to the goods passes from seller to buyer and (2) who pays the freight. Exhibit 5-4 summarizes FOB terms.

Exhibit 5-4 FOB Terms Determine Who Pays Freight



Freight costs are either *Freight in* or *Freight out*.

- Freight in is the transportation cost on *purchased goods*.
- Freight out is the transportation cost on *goods sold*.

Freight In FOB shipping point terms are most common, so the buyer pays the freight. Freight in becomes part of the cost of inventory. The buyer debits Inventory and credits Cash or Accounts Payable for the freight. Suppose Austin Sound pays a \$60 shipping bill. Austin Sound's entry to record payment of the freight charge is

June 1 Inventory 60
Cash 60
Paid a freight bill.

A Running Glossary provides a full definition when a term is introduced. A list of terms appears at the end of each chapter, and there is a complete Glossary at the end of the book.

SALES DISCOUNTS AND SALES RETURNS AND ALLOWANCES We just saw that purchase returns and allowances and purchase discounts decrease the cost of inventory purchases. In the same way, **sales returns and allowances** and **sales discounts**, which are contra accounts to Sales Revenue, decrease the net amount of revenue earned on sales.

Sales Returns and Allowances

Decreases in the seller's receivable from a customer's return of merchandise or from granting the customer an allowance from the amount owed to the seller. A contra account to Sales Revenue.

Sales Discount

Reduction in the amount receivable from a customer, offered by the seller as an incentive for the customer to pay promptly. A contra account to Sales Revenue.

Net Sales Revenue

Sales revenue less sales discounts and sales returns and allowances.

CREDIT-BALANCE ACCOUNT

Sales Revenue

DEBIT-BALANCE ACCOUNTS

Sales Returns and Allowances

Sales Discounts

CREDIT SUBTOTAL (NOT A SEPARATE ACCOUNT)

Net sales revenue!

Companies maintain separate accounts for Sales Discounts and Sales Returns and Allowances. Now let's examine a sequence of JVC sale transactions. Assume JVC is selling to Austin Sound Center.

On July 7, JVC sells stereo components for \$7,200 on credit terms of 2/10 n/30. These goods cost JVC \$4,700. JVC's entries to record this credit sale and the related cost of goods sold are

July 7 Units Received

Because Austin Sound sold goods, the business also must decrease the Inventory balance. Suppose these goods cost the seller \$1,900. A second journal entry is needed to transfer the \$1,900 cost of the goods from the Inventory account to Cost of Goods Sold, as follows: →

June 9 Cost of Goods Sold 1,900
Inventory 1,900
Recorded the cost of goods sold.

The recording of cost of goods sold along with sales revenue is an example of the matching principle (Chapter 3, p. 95)

Unique! Concept Links help you remember material learned earlier. Concept links in the side margins point you to relevant topics covered earlier: they provide both a rationale for the material and a chapter and text page cross reference.

Stop & Think

This Stop & Think example is exactly like the preceding one, but with freight in. On September 15, Austin Sound purchased \$1,000 of merchandise, with \$80 freight added, for an invoice total of \$1,080. Austin returns \$100 of the goods for credit on September 20 and pays the account payable in full on September 25. Journalize these transactions.

Answer

Purchase: Sept. 15	Inventory (\$1,000 + \$80)	1,080	
	Accounts Payable		1,080
Return: Sept. 20	Accounts Payable	100	
	Inventory		100
Payment: Sept. 25	Accounts Payable (\$1,080 - \$100)	980	
	Inventory [(\$1,000 - \$100) × 0.02]		18
	Cash (\$1,000 + \$80 - \$100 - \$18)		962

There is no discount on freight.

Stop & Think exercise boxes appear within the text in every chapter. The exercises encourage you to assess your understanding of concepts by providing immediate practice of what you have just learned.

Amazon.com: For E-Tailers Free Shipping Isn't Free, But It's Not a Cost, Either



Like most accounting students, Jennifer didn't have time to go Christmas shopping. She cruised the online mall and ended up buying all her presents from Amazon.com, the largest player in online retailing. Jennifer was lured by Amazon.com's huge selection and an offer of free shipping for all orders over \$25.

Amazon.com views free shipping as a key factor in boosting its growth—revenue jumped 233% to \$851 million in one year. Yet, the company doesn't send

packages via eight trusty reindeer. Amazon has to pay freight companies to deliver DVD players, books, and blenders to customers around the world. How does an e-tailer—one that is just barely making a profit—account for these shipping and handling costs?

Fortunately for Amazon and other e-tailers, in the process of revolutionizing business, e-commerce has also bent certain accounting rules. One such rule is that the cost of products sold to customers is usually recorded as Cost of Goods Sold, a merchandiser's major expense. But online powerhouses like Amazon.com and Buy.com count some of this cost as "sales and marketing expenses." By listing these "fulfillment costs" as marketing expenses, both e-tailers and catalog houses such as L.L. Bean don't have to subtract the expense in arriving at gross profit.

Small wonder that this controversial approach came under investigation by the Financial Accounting Standards Board (FASB). The dot-com bubble had burst, and e-tailers were poised to reclassify shipping and handling costs as costs of goods sold. That would restate gross profit downward. However, the Emerging Issues Task Force of the FASB recommended that shipping and handling revenue should be included in sales, without giving any guidance about how to account for shipping and handling costs. So Amazon and other e-tailers are free to continue including shipping and handling costs under marketing expense. The result: Gross profits are still high.

Based on: Nick Winfield, "Survival Strategy: Amazon Takes Page from Wal-Mart to Prosper on Web—Internet Retailer Cuts Prices and Keeps Eye on Costs in Bid for High Volumes—Betting Big on Free Shipping," The Wall Street Journal, November 22, 2002, p. A1; Saul Hansell, "Amazon's Loss in Quarter Shows a Sharp Decrease," The New York Times, October 25, 2002, p. 8; Katherine Hobson, "Silver Lining: FASB Spares E-Tailers in Cost Ruling," The Street.com, August 8, 2000.

Accounting.com boxes Nothing has changed business more in recent years than the Internet. Horngren/Harrison/Bamber's Accounting.com boxes identify accounting issues affecting companies doing business on the Web.

MID-CHAPTER Summary Problem

Suppose Amazon.com engaged in the following transactions during June of the current year:

- June 3 Purchased inventory on credit terms of 1/10 net eom (end of month), \$1,600.
- 9 Returned 40% of the inventory purchased on June 3. It was defective.
- 12 Sold goods for cash, \$920 (cost, \$550).
- 15 Purchased goods for \$5,000. Credit terms were 3/15 net 30.
- 16 Paid a \$260 freight bill on goods purchased.
- 18 Sold inventory on credit terms of 2/10 n/30, \$2,000 (cost, \$1,180).
- 22 Received returned goods from the customer of the June 18 sale, \$800 (cost, \$480).
- 24 Borrowed money from the bank to take advantage of the discount.



Summary Problems This unique Horngren/Harrison/Bamber feature enables you to pause and assess your progress at two locations within each chapter—midway and again at the end of the chapter text. Solutions appear with the problems for immediate feedback.

END-OF-CHAPTER Summary Problem



The adjustment data and trial balance of Jan King Distributing Company follow. (The solution to Requirement 1 is on page 208.)

Adjustment data at December 31, 20X6:

- a. Supplies used during the year, \$2,580.
- b. Prepaid rent in force, \$1,000.
- c. Unearned sales revenue still not earned, \$2,400.
- d. Depreciation. The furniture and fixtures' estimated useful life is 10 years, and they are expected to be worthless when they are retired from service.
- e. Accrued salaries, \$1,300.
- f. Accrued interest expense, \$600.
- g. Inventory on hand, \$65,800.

Required

1. Enter the trial balance on a work sheet and complete the work sheet.
2. Journalize the adjusting and closing entries at December 31. Post to the Income Summary account as an accuracy check on the entries affecting that account. The credit balance closed out of Income Summary should equal net income computed on the work sheet.
3. Prepare the company's multi-step income statement, statement of owner's equity, and balance sheet in account format. Draw arrows linking the statements.
4. Compute the inventory turnover for 20X6. Inventory at December 31, 20X5, was \$61,000. Turnover for 20X5 was 2.1 times. Would you expect Jan King Distributing Company to be more profitable or less profitable in 20X6 than in 20X5? Give your reason.

A+ Tips reminders appear with both Mid-Chapter and End-of-Chapter review problems.

Unique! Decision Guidelines show when, why, and how managers—not just accountants—use accounting information to make good business decisions.

Excel Application Exercises Every business professional must know how to use Excel, and Horngren/Harrison/Bamber provides the tools you need to master it. Excel Application Exercises appear in each chapter, with instructions for creating your own spreadsheets. Spreadsheet templates appear on the CD.

Decision Guidelines

MERCHANDISING OPERATIONS AND THE ACCOUNTING CYCLE

Amazon.com and Kinko's Copy Centers are two very different companies. How do Amazon and Kinko's differ? How are they similar? The Decision Guidelines answer these questions.

Decision

How do merchandisers differ from service entities?

How do a merchandiser's financial statements differ from the statements of a service business?

Income Statement:

Merchandiser

Sales revenue	.....	\$XXX
— Cost of goods sold	.....	(X)
= Gross profit	.....	XX
— Operating expenses	.....	(X)
= Net income	.....	\$ X

Statements of Owner's Equity:

Which type of inventory system to use?

Guidelines

- Merchandisers, such as Amazon.com, buy and sell merchandise inventory.
- Service entities, such as Kinko's, perform a service.

Balance sheet:

- Merchandiser has inventory, an asset.
- Service business has no inventory.

Service Business

Service revenue	.....	\$ XX
— Operating expenses	.....	(X)
= Net income	.....	\$ X

No difference

- Perpetual system shows the amount of inventory on hand (the asset) and the cost of goods sold (the expense) at all times.
- Periodic system shows the correct balances of inventory and cost of goods sold only after a physical count of the inventory, which occurs at least once each year.

Excel Application Exercise

Goal: Create a spreadsheet to compute Amazon.com's gross profit percentage and inventory turnover for the past three years.

Scenario: You are intrigued by Amazon's ability to sell merchandise via the Internet and would like to invest in such a venture. Before doing so, however, you remember from your accounting course that ratio analysis is an important part of making an investment decision. You decide to calculate two key ratios: gross profit percentage and inventory turnover. (You may need to visit Amazon.com on the Web to find inventory data from past years. Look under Investor Relations at the bottom of the Home page.) When you have completed your worksheet, answer the following questions:

1. What has happened to Amazon's gross profit percentage over the past three years?
2. What can you tell about Amazon's inventory operations from its inventory turnover ratio for the past two years?

Step-by-Step:

1. Open a new Excel spreadsheet.
2. In column 1, create a bold-faced heading as follows:
 - a. Chapter 5 Excel Application Exercise
 - b. Evaluating Amazon Inventory Operations
 - c. Today's Date
3. Two rows down and two columns over, create bold and underlined headings for the most recent three years (e.g., 2002, 2001, and 2000).
4. In column A, enter the following (one per row):
 - a. Net Sales (in thousands)
 - b. Cost of Goods Sold (Cost of Sales)
 - c. Gross Profit
 - d. Inventory
 - e. Gross Profit Percentage
 - f. Inventory Turnover
5. Locate the data for items a-d in the Amazon.com annual report (or on the Web) and enter it in the appropriate columns.
6. Calculate gross profit percentage and inventory turnover. To help visualize the data trends, use the Chart Wizard to create a bar graph of performance.
7. Format all columns, rows, and data as needed. Save your work and print a copy for your files.

Assignment Materials

New! Starters Starters serve as warm-ups and confidence builders at the beginning of the assignment material. Try to solve these easy, single-concept exercises. Each Starter is referenced within the chapter so that if you need more guidance, you know exactly what material to review to complete the exercise.

ASSESS Your Progress

Online homework

See www.prenhall.com/horngren for selected Starters, Exercises, and Problems.

Recording purchase and cash payment transactions
(Obj. 1)

Accounting for the purchase of inventory—purchase discount
(Obj. 1)

Recording purchase, purchase return, and cash payment transactions.
(Obj. 1)

Starters

S5-1 You may have shopped at a Gap store. Suppose Gap purchases 2,000 pairs of slacks on account for \$50,000. Credit terms are 2/10 n/30. Gap paid within the discount period. Journalize the following transactions for Gap:

- a. Purchase of inventory.
- b. Payment on account.

S5-2 Toys “Я” Us purchases inventory from a variety of suppliers, including Mattel, Hasbro, and Tonka. Suppose Toys “Я” Us buys \$150,000 worth of Lego toys on credit terms of 3/15 n/45. Some of the goods are damaged in shipment, so Toys “Я” Us returns \$50,000 (original amount, before any discounts) of the merchandise to Lego.

- a. After the discount period?
- b. Within the discount period?

S5-3 Refer to the Toys “Я” Us situation in Starter S5-2 and journalize the following transactions on the books of Toys “Я” Us. Explanations are not required.

- a. Purchase of the goods on May 6, 20X5.

- ✓ Starter S5-2
- ✓ Starter S5-3
- ✓ Starter S5-4

Stop & Think

Accounts Payable			
Return	100	Purchase	1,000
		Bal.	900

ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
Inventory	=	Accounts Payable		
— \$100	=	— \$100	+	\$0

On September 15, Austin Sound purchases \$1,000 of merchandise on account, with terms 2/10, n/30. Austin returns \$100 of merchandise for credit on September 20, then makes payment in full on September 25. Journalize these transactions.

Answer: Three separate journal entries are needed. The purchase entry is

1. Purchase: Sep. 15	Inventory	.....	1,000	
	Accounts Payable	.....		1,000

The second entry records the return of inventory, as follows:

2. Return: Sep. 20	Accounts Payable	.....	100	
	Inventory	.....		100

REVIEW Merchandising Operations

Quick Check

- Which account does a merchandiser, but not a service company, use?
 - Inventory
 - Sales revenue
 - Cost of goods sold
 - All of the above
- The two main inventory accounting systems are the
 - Purchase and sale
 - Perpetual and periodic
 - Cash and accrual
 - Returns and allowances
- The journal entry for the purchase of inventory on account is
 - Inventory..... XXX
Accounts Receivable..... XXX
 - Accounts Payable..... XXX
Inventory..... XXX
 - Inventory..... XXX
Accounts Payable..... XXX

E5-14 Marcia Walker's consulting practice performs systems consulting. Walker has also begun selling accounting software. During January, the business completed these transactions:

- Completed a consulting engagement and received cash of \$7,200.
- Prepaid three months' office rent, \$1,500.
- Purchased accounting software inventory on account, \$4,000.
- Paid employee salary, \$1,400.

Accounting for both merchandising and service operations
(Obj. 1, 2, 4, 5)
Student Resource CD
General Ledger, Peachtree, QuickBooks

A+ online homework

Explaining the perpetual inventory system
(Obj. 1, 2)

Problems

(Group A)

P5-1A Lens Masters is a regional chain of optical shops. The company offers a large selection of eyeglass frames, and Lens Masters stores provide while-you-wait service. The company has launched a vigorous advertising campaign to promote two-for-the-price-of-one frame sales.

Required

Lens Masters expects to grow rapidly and to increase its level of inventory. As the chief accountant of this company, you wish to install a perpetual inventory system. Write a one-paragraph business memo to the company president to explain how that system would work for the purchase and sale of eyeglasses. Use the following heading for your memo:

APPLY Your Knowledge

Expanding a business
(Obj. 5)

Decision Cases

Case 1. Lauren Sever and Trey Hagins opened Party-Time T-Shirts to sell T-shirts for parties at their college. The company completed the first year of operations, and Sever and Hagins are generally pleased with operating results, as shown by the following income statement:

Party-Time T-Shirts Income Statement Year Ended December 31, 20X6

Net sales revenue.....	\$350,000
Cost of goods sold	210,000
Gross margin	140,000
Operating expenses:	
Selling expense.....	40,000

Ethical Issue

Hunter Glass Company makes all sales under terms of FOB shipping point. The company usually receives orders for sales approximately one week before shipping inventory to customers. For orders received late in December, Donny Hunter, the owner, decides when

Financial Statement Case

This case uses both the income statement (statement of operations) and the balance sheet of Amazon.com in Appendix A. It will help you understand the closing process of a business.

Required

- Journalize Amazon.com's closing entries for the revenues and expenses of 2002. Show all amounts in thousands as in the Amazon financial statements. You may be unfamiliar with certain revenues and expenses, but treat each item on the income statement as either a revenue or an expense. For example, Net Sales is the first revenue, and Interest Income is also a revenue. The last revenue is Cumulative Effect of Change in Accounting Principle. A loss is like an expense. In your closing entries, show all debits and credits for Cost of Sales, Total Operating Expenses, and Net Loss.

Closing entries and the gross profit percentage
(Obj. 4, 6)

Team Project

With a small team of classmates, visit one or more merchandising businesses in your area. Interview a responsible official of the company to learn about its inventory policies and accounting system. Obtain answers to the following questions, write a report, and be prepared to make a presentation to the class if your instructor so directs:

Required

- What merchandise inventory does the business sell?
- From whom does the business buy its inventory? Is the relationship with the supplier new or longstanding?
- What are the FOB terms on inventory purchases? Who pays the freight, the buyer or the seller? Is freight a significant amount? What percentage of total inventory cost is the freight?
- What are the credit terms on inventory purchases—2/10 n/30, or other? Does the business pay early to get purchase discounts? If so, why? If not, why not?
- How does the business actually pay its suppliers? Does it mail a check or pay electronically?

New! Quick Check These new multiple-choice questions appear at the ends of chapters so you can test your understanding of material before taking multiple-choice exams. Answers to Quick Checks appear in Appendix D at the end of the book

Exercises and Problems Exercises and Problems give you plenty of practice in solving accounting dilemmas and checking your understanding of major concepts in the chapter.

Cases A variety of cases, plus **Team Projects**—and **Comprehensive Problems** at the ends of groups of chapters—give you opportunities to practice decision-making in real business situations. Cases include **Decision Cases**, **Ethical Issues**, and **Financial Statement Cases** that use the **Amazon.com** annual report at the end of the book.

Comprehensive Problem for Chapters 1–7

COMPLETING THE ACCOUNTING CYCLE FOR A MERCHANDISING ENTITY—USING SPECIAL JOURNALS

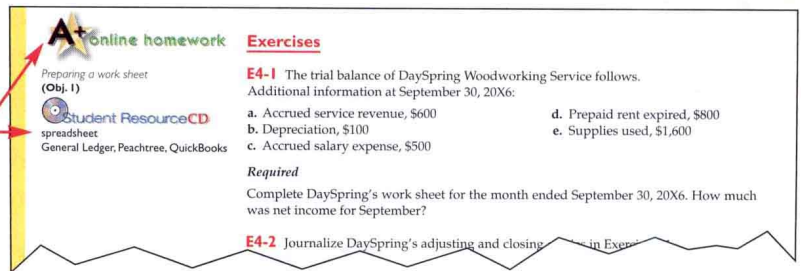
Digital Meter Company closes its books and prepares financial statements at the end of each month. Digital uses the perpetual inventory system. The company completed the following transactions during August:

- Issued check no. 682 for August office rent of \$1,000. (Debit Rent Expense.)
- Issued check no. 683 to pay the salary payable of \$1,250 from July 31.
- Issued invoice no. 503 for sale on account to R. T. Loeb, \$600. Digital's cost of this merchandise was \$190.
- Purchased inventory on credit terms of 1/15 n/60 from Grant, Inc., \$1,400.

Received net amount of cash on account from R. T. Loeb Company.

Study Aids And Resources

Throughout the book, margin icons indicate resources available on the **Student Resource CD**. Selected end-of-chapter problems appear in **spreadsheet templates** on the CD, and also in **General Ledger (GL)**, **QuickBooks (QB)**, and **Peachtree (PT)** formats. Other assignments are linked to Prentice Hall's new online homework program that includes a variety of assignments whose results feed directly into the grading program. The program includes algorithm-based problems, to give you extensive practice on a single concept.



The image shows a portion of a textbook page with margin icons and exercises. On the left, there are three icons: a star with 'A+' (labeled 'online homework'), a CD (labeled 'Student ResourceCD'), and a document with a pencil (labeled 'Writing Assignment'). To the right of these icons, the text reads: 'Preparing a work sheet (Obj. 1)' and 'spreadsheet General Ledger, Peachtree, QuickBooks'. Further right, under the heading 'Exercises', there are two exercises: 'E4-1 The trial balance of DaySpring Woodworking Service follows. Additional information at September 30, 20X6: a. Accrued service revenue, \$600 b. Depreciation, \$100 c. Accrued salary expense, \$500 d. Prepaid rent expired, \$800 e. Supplies used, \$1,600' and 'E4-2 Journalize DaySpring's adjusting and closing entries in Expense'.

New Student and Instructor Resource CD-ROMs This innovative product includes all resources for the text—Powerpoint files, video clips, spreadsheet templates, tutorial software, General Ledger software, and Peachtree and QuickBooks software. You can access resources by chapter or by keyword (like “LIFO”). The student version of the CD allows you to create your own individualized review program. Free with new texts.



Text Icons



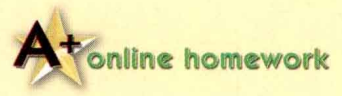
Resources



Resource CD



Writing Assignment



Online homework program

Study Guide This chapter-by-chapter learning aid systematically and effectively helps you study accounting and get the maximum benefit from study time. Each chapter provides a Chapter Overview and Review, a Featured Exercise that covers in a single exercise all of the most important topics in the chapter, and Review Questions and Exercises that test your understanding of the material.

Powerpoint slides help you review concepts by providing a summary of important points. *Remember!* You can choose to review **Powerpoints** by chapter or by keyword.

Video Clips include a series of **tutorial videos** designed to help you review concepts, plus **On Location! Videos** that take you inside companies such as **Jelly Belly** and **It's Just Lunch** to show you how managers use accounting information to make everyday business decisions. *Remember!* You can choose to review **videos** by chapter or by keyword.

Spreadsheet templates Selected end-of-chapter exercises and problems appear on pre-created templates for you to use in solving these assignments. If you need additional help in using Excel, you may opt to review the tutorial segment.

More Study Aids

General Ledger Software enables you to complete homework assignments using a general ledger software package. You may also enter and solve your own problems. E-Working Papers are available for each chapter.

New! Getting Started If your professor has chosen to package one of the Getting Started series manuals with your text, you may access the data files to use with the manuals.

Companion Website www.prenhall.com/horngren Prentice Hall's Learning on the Internet Partnership offers extensive Internet-based support. Our Web sites provide a wealth of free resources for you, including Student Study Hall, Online Tutorial Assistance, Study Guide with Quizzes, Internet Exercises, and much more.

For The Instructor

WHAT'S NEW FOR THE SIXTH EDITION? HORNGREN MAKES IT EASIER TO MOTIVATE STUDENTS TO SUCCEED!

(A complete list of chapter-by-chapter highlights follows this overview)

Text & Assignment Material

- **New Amazon.com Annual Report & Financial Statement Analysis Cases!** New copies of the text now include the Amazon.com annual report. This is linked to many of the chapter-opening vignettes, and end-of-chapter financial statement analysis cases.
- **New Theme: Show More. Say Less.** Throughout the text, the authors have worked hard to tighten and focus the content on core topics in first year accounting.
- **New, more open and student-friendly design** includes many new exhibits to aid in student understanding.
- **New Chapter Organization.** The chapters on merchandising and inventory (previously Chapters 5 & 9) are now Chapters 5-6 to enable students to link these topics more easily.
- **New A+Tips** at each chapter opening list resources to help students learn key concepts; reminders appear within the chapter.
- **New Quick Check Questions.** New multiple-choice exercises at the ends of chapters enable students to test their understanding before taking multiple-choice examinations. Answers appear in Appendix D.
- **New Starters** (previously called "Daily Exercises") serve as warm-ups/confidence builders at the beginning of the assignment material. Students solve these easy, single-concept exercises (many using real companies). Each problem is referenced to material within the chapter so that if students need more guidance, they know exactly what to review to complete the exercise.
- **New Excel Application Exercises,** now for each chapter in the book, with spreadsheet solutions.

Grading & Practice

- **New Peachtree, QuickBooks, and General Ledger Assignments.** Selected end-of-chapter problems are available on templates for Peachtree, QuickBooks, and General Ledger software. In addition, instructors may opt to package a brief introductory manual on the latest release of Peachtree or QuickBooks at no charge with new texts.
- **New Manual and Computerized Practice Sets** include optional exercises using Peachtree and QuickBooks. Package any Practice Set at 50% off with new texts.
- **New Automatic Homework Grading!** Prentice Hall's online homework program includes a variety of in-text assignments for students to complete online—and results feed directly into the grading program. The program includes

 **online homework**

algorithm-based problems that enable students to have extensive practice on a single concept. They *reduce cheating* because two students sitting next to one another could see different versions of the problem (the instructor determines whether the problem is viewed in static or algorithm-based format). Students get extensive feedback to help them understand where they went wrong.

The New CD



Student ResourceCD

- **New Instructor and Student Resource CD-ROMs:** This innovative CD-ROM includes all resources for the text and allows instructors to create custom multi-media lectures in less than 5 minutes! Access the resources by chapter or keyword (e.g., "LIFO"). A student version of the CD enables students to create individualized review programs. Free with new texts.

Chapter-by-Chapter Highlights

CHAPTER 1 Accounting and the Business Environment

- New chapter opener focuses on **Amazon.com**, the feature company for this edition.
- Discussion of ethics in accounting features **Enron**, **WorldCom**, and **Xerox**.
- New illustration of the effects of transactions on balance sheet and income statement.

CHAPTER 2 Recording Business Transactions

- New chapter opener features **Frito-Lay**.
- New notations for journal entries clarify the rules of debit and credit.
- New roadmap shows how accounts, ledgers, journals, and the trial balance fit together.

CHAPTER 3 The Adjusting Process

- New notations for adjusting entries clarify the rules of debit and credit.
- New graphic shows the difference between the accrual basis and the cash basis.

CHAPTER 4 Completing the Accounting Cycle

- New chapter opener features the **Chicago Cubs** baseball team.
- New exhibit illustrates the closing process.
- Dell Computer's balance sheet illustrates the accounts covered to date.

CHAPTER 5 Merchandising Operations

- New chapter opener features **Amazon.com**.
- This completely revised chapter begins with purchase of merchandise, then moves to sales, all based on the perpetual system.

- Appendix on the periodic system.

CHAPTER 6 Merchandise Inventory

- New chapter opener features **Columbia Sportswear** and the **International Balloon Festival**.
- New exhibits! One shows the effect of merchandising on the financial statements; another shows FIFO, LIFO, and average costing; and others show the relationship between transactions in a perpetual system and related journal entries.
- New, streamlined coverage of accounting for inventory in a periodic system.

CHAPTER 7 Accounting Information Systems

- New discussion of Enterprise Resource Planning (ERP) systems.
- New explanation of the relationship between manual and computerized systems.

CHAPTER 8 Internal Control and Cash

- Discussion of the Sarbanes-Oxley Act and internal controls.
- Streamlined discussion of the bank reconciliation.
- New graphics: internal controls for cash receipts and cash payments.
- New: Enron examples to illustrate ethics in accounting.

CHAPTER 9 Receivables

- Simplified examples to illustrate accounting for uncollectibles.
- New graphics: integration of order entry, shipping, and billing of receivables.

CHAPTER 10 Plant Assets and Intangible Assets

- New chapter opener features airlines and their assets.
- New exhibit: relationship between plant assets and related expenses.
- New graphic: relative-sales-value method.
- Streamlined coverage of Depreciation and Income Taxes.
- Simplified coverage of Partial-Year Depreciation.
- Updated accounting for goodwill.

CHAPTER 11 Current Liabilities and Payroll

- New chapter opener features **General Motors**, **Sony**, and **Goodyear**.
- New graphic: how to allocate interest expense to the appropriate period.
- Streamlined accounting for sales tax payable.
- Beefed up—and streamlined—coverage of accounting for contingencies.
- Simplified payroll illustrations.
- Added Form 941, Employer's Quarterly Federal Tax Return.

CHAPTER 12 Partnerships

- New chapter opener on the fragility of partnerships, featuring the **Arthur Andersen** debacle.
- New graphics illustrate the various ways to start a partnership.

CHAPTER 13 Corporations: Paid-in Capital and the Balance Sheet

- New discussion of closing net income for a corporation.
- Streamlined accounting for income tax by a corporation.

CHAPTER 14 Retained Earnings, Treasury Stock, and the Income Statement

- New chapter opener features **Coca-Cola**, **Dell Computer**, and **Pier 1 Imports**.
- New graphic: retained earnings are not cash.
- New coverage of stock dividends.
- Scaled-down treatment of the corporate income statement.
- Simplified treatment of earnings per share.

CHAPTER 15 Long-term Liabilities

- Revised chapter opener features **Amazon.com**.

- New roadmap guides students through issuing bonds payable to borrow money.
- Deleted sections on Leases and Pensions.

CHAPTER 16 Investments and International Operations

- New chapter opener features **McDonald's**, **Panasonic**, and **Nokia**.
- Scaled-down coverage of accounting for international operations.

CHAPTER 17 The Statement of Cash Flows

- New chapter opener features **eBay**.
- Completely revised chapter: Two distinct sections for the indirect method and the direct method. Each section features step-by-step preparation of the statement.
- Scaled-down level of complexity for both methods—fewer accounts to analyze.
- New graphics: how cash is affected by changes in the other current accounts.

CHAPTER 18 Financial Statement Analysis

- New chapter opener features **Bristol-Myers Squibb**.
- Revised chapter organized around decisions and the need for financial statement analysis.
- New graphics illustrate horizontal analysis and vertical analysis.
- Scaled-down financial statements—fewer accounts to analyze.
- Revised discussions of the ratios—shorter paragraphs, fewer words.
- New section on Red Flags in Financial Statement Analysis.
- New section on Analyzing Nonfinancial Data.

CHAPTER 19 Introduction to Management Accounting

- New chapter opener and **On Location!** video on **Regal Marine**.
- New infographics.
- New exhibit simplifies and clarifies the distinction between merchandisers' and manufacturers' income statements.
- Simplified discussion of cost of goods manufactured, linking the flow of activities.
- Brief new discussion of ERP systems.

CHAPTER 20 Job Costing

- Updated chapter opener: why and how **Dell** figures the cost of a built-to-order computer.
- Emphasis on why all managers need to know how much it costs to produce a product or to serve a customer.
- Reorganized and simplified discussion of accounting for materials and labor.
- Exciting new team project asks students to compare the cost (and profits) of regular airlines' versus budget airlines' flights, using real-world data.

CHAPTER 21 Process Costing

- New chapter opener and **On Location!** video feature **Jelly Belly**.
- Text discussion uses Jelly Belly to illustrate key process costing principles.
- *First half* of chapter enables students to grasp the basics of process costing without complications caused by the presence of beginning work in process inventory. Instructors who prefer to introduce the basics of process costing can assign just the first half of the chapter. There is plenty of relevant assignment material.
- The *second half* of the chapter allows for beginning inventories. Scaled-back coverage focuses on the process costing method students find easiest to grasp—weighted average.
- Full and self-contained coverage of the more complex FIFO method appears in a new appendix. Instructors can add—or substitute—the FIFO-based appendix for the second half of the chapter.
- Several new Decision Guidelines emphasize the big picture—job versus process costing, the checks and balances in the 5-step process costing approach illustrated in the chapter, the goal of process costing, and how managers use the production cost report.

CHAPTER 22 Cost-Volume-Profit Analysis

- Streamlined presentation of variable, fixed, and mixed costs.
- Significantly reorganized chapter: Illustrations proceed from cost behavior, to basic CVP analysis, to using CVP analysis for profit planning, to conducting sensitivity analyses with CVP.
- Chapter midpoint now follows basic CVP analysis. This speed bump prompts students to reinforce their understanding of the basics.

- Significantly revised discussion of sensitivity analyses includes realistic business decision contexts for changing various components of the CVP analysis, covers the margin of safety, and explains how managers use information technology.

CHAPTER 23 The Master Budget and Responsibility Accounting

- New chapter opener features **Amazon.com** CEO Jeff Bezos' use of budgets to control costs.
- Focus on Amazon.com throughout chapter, including new Decision Guidelines contexts, new end-of-chapter multiple-choice questions, and several new infographics.
- New pedagogy moves from students' personal budgets, to a simple budget for a small company, to the main example featuring a retail store's budget, to how large companies use software to roll up individual unit budgets into the companywide budget.
- Emphasizes how managers *use* the budget to plan and control, and also considers behavioral issues such as tips for increasing employees' acceptance of the budget.
- New infographic organization chart coupled with a new exhibit showing a responsibility performance report illustrate how responsibility accounting works in a real-world context.

CHAPTER 24 The Flexible Budget and Standard Costs

- New introductory example based on students' daily life shows why variances are important guides to future action.
- Mid-chapter Decision Guidelines and new Excel exercise show how students can use flexible budgets and variances to plan and control costs in start-up businesses.
- New discussion of how managers set price and quantity standards.
- Significantly streamlined discussion of allocating manufacturing overhead in a standard costing system
- Streamlined explanation of overhead variances: more visuals, fewer words.

CHAPTER 25 Activity Based Costing and Other Cost Management Tools

- Streamlined and updated discussion of how managers use activity-based management in pricing, product mix, and cost-cutting decisions.

(continued)

(Chapter 25 continued)

- Streamlined discussion of when ABC passes the cost-benefit test.
- Simplified discussion of the just-in-time philosophy and total quality management.
- New Financial Statement Case highlights Amazon.com's unique activities as an e-tailer.

CHAPTER 26 Special Business Decisions and Capital Budgeting

- New graphics: decision rules for special short-term decisions such as special orders, product mix, and sell or process further.
- Simplified coverage of special sales orders.

- Discussion and new examples of the trend toward outsourcing all kinds of business functions.
- Simplified illustration of opportunity costs in the context of decisions on best use of facilities and outsourcing.
- New graphics: decision rules for long-term capital budgeting decisions.
- Simplified coverage of net present value.
- New Financial Statement Case asks students to apply payback, accounting rate of return, and discounted cash flow techniques to Amazon.com's investments.

Instructor Resources

Everything you need where you need it. The Prentice Hall Instructor Resource Center/CD-ROM increases your effectiveness and saves you time and effort.

Harness the power of having all of your resources in one well-organized place. Because resources should simplify, not overwhelm.

Technology Resources: How Horngren Makes It Easier for You to Test and Grade

NEW! INSTRUCTOR AND STUDENT RESOURCE CD-ROMs

These CD's are powerful teaching and learning tools. They first serve as a roadmap through the chapters to identify key concepts and then guide students to other resources on the CD-ROM, where they can further develop their skills.

- Available in separate versions for faculty and students, this unique tool enables faculty to **save time** and **quickly prepare highly effective and interactive multimedia classroom presentations**.
- Using a **highly accessible menu**, students and faculty can easily customize study programs or presentations. By simply clicking on a chapter or keyword, they can access an interactive library of resources.
- Instructor's CD-ROM contains all ancillaries. Student CD-ROM contains tutorial software, On Location! video clips, PowerPoints, General Ledger software, Excel tutorial, spreadsheet templates, and much more.

These CD-ROMs also contain a special option for instructors who wish to build their own online courses! Faculty can pick and choose from the various supplements (organized by chapter and topic), and export them to their hard drive in HTML. From hard drive to online course is an easy step!

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