

FINANCIAL ACCOUNTING

Second Edition

Nikolai / Bazley

SECOND EDITION

Financial Accounting

Loren A. Nikolai, Ph.D., CPA

Ernst & Whinney Professor, School of Accountancy
University of Missouri – Columbia

John D. Bazley, Ph.D., CPA

Professor, School of Accountancy
University of Denver



KENT PUBLISHING COMPANY

A Division of Wadsworth, Inc.
Boston, Massachusetts

Senior Editor: John B. McHugh
Production Editor: Nancy J. Crow
Designer: George McLean; Anna Post
Cover Design: Nancy Lindgren
Manufacturing Manager: Linda E. Siegrist

Kent Publishing Company

A Division of Wadsworth, Inc.

© 1986 by Wadsworth, Inc., 10 Davis Drive, Belmont, California 94002. All rights reserved. No part of this book may be reproduced, stored in a retrieval system, or transcribed, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the publisher, Kent Publishing Company, 20 Park Plaza, Boston, Massachusetts 02116.

Printed in the United States of America

1 2 3 4 5 6 7 8 9—90 89 88 87 86

Library of Congress Cataloging-in-Publication Data

Nikolai, Loren A.
Financial accounting.

Includes index.

1. Accounting. I. Bazley, John D. II. Title
HF5635.N692 1986 657 85-23163
ISBN 0-534-05694-6

Material from *Accounting Research Bulletins*, *Accounting Principles Board Opinions*, *Accounting Principles Board Statements*, *Accounting Interpretations*, and *Accounting Terminology Bulletins* is reprinted with the permission of the American Institute of Certified Public Accountants, Inc., copyright © 1968, 1969, 1970, 1971, 1972, 1973, 1974, 1975, 1976, 1977, 1978, 1979, 1980, 1981, 1982, 1983, 1984, 1985.

This book contains citations from various FASB pronouncements. Copyright © by Financial Accounting Standards Board, High Ridge Park, Stamford, Connecticut, 06905, U.S.A. Reprinted with permission. Copies of the complete document are available from the FASB.

About the Authors

Loren A. Nikolai

Loren A. Nikolai, Ph.D., CPA, is the Ernst & Whinney Professor in the School of Accountancy at the University of Missouri, Columbia. He received his M.B.A. from St. Cloud State University and his Ph.D. degree from the University of Minnesota. Professor Nikolai has taught at the University of Wisconsin at Platteville and at the University of North Carolina at Chapel Hill. He has received awards for outstanding teaching at both the University of Wisconsin at Platteville and the University of Missouri. He holds a CPA certificate in the state of Missouri and previously worked for the 3M Company. Professor Nikolai is the lead author of *Intermediate Accounting* (third edition) and *Principles of Accounting* (second edition) textbooks (Kent Publishing Company). He has published numerous articles in *The Accounting Review*, *Journal of Accounting Research*, *The CPA Journal*, *Management Accounting*, *Policy Analysis*, *Academy of Management Journal*, *Journal of Business Research*, and other professional journals. He was also lead author of a monograph published by the National Association of Accountants. Professor Nikolai is the Faculty Vice President of the Beta Alpha Psi chapter at UMC. He is a member of the American Accounting Association, the American Institute of Certified Public Accountants, and the Missouri Society of CPAs. He has chaired or served on several American Accounting Association committees, and is Director of Education for 1985–87.

John D. Bazley

John D. Bazley, Ph.D., CPA, is Professor of Accounting in the School of Accountancy at the University of Denver. Dr. Bazley earned a B.A. from the University of Bristol in England and an M.S. and Ph.D. from the University of Minnesota. He has also taught at the University of North Carolina at Chapel Hill and holds a CPA certificate in the State of Colorado. He has taught national professional development classes for a major CPA firm. Dr. Bazley is coauthor of *Intermediate Accounting* (third edition) and *Principles of Accounting* (second edition) textbooks (Kent Publishing Company). Dr. Bazley has published articles in professional journals, including *The Accounting Review*, *Management Accounting*, and the *Academy of Management Journal*. He is also a coauthor of a monograph on Environmental Accounting published by the National Association of Accountants. He is a member of the American Institute of Certified Public Accountants, the Colorado Society of Certified Public Accountants, the American Accounting Association, and the National Association of Accountants.

Preface

Purpose

Our goal in writing this elementary financial accounting text is to provide students with a solid foundation in the dynamic and growing field of accounting. Accounting majors using this text will obtain a thorough understanding of financial accounting fundamentals. This will help to reduce the gap frequently encountered by students moving from beginning to intermediate and advanced courses. Nonaccounting majors will find the thorough grounding in financial accounting presented in this text to be valuable in their future careers as bankers, managers, investors, or perhaps as owners of their own businesses.

General Overview

Financial Accounting, second edition has been developed for a one-semester (two quarter) sequence in elementary financial accounting. It is written with the same care and thought as our *Intermediate Accounting* (third edition) textbook (by Nikolai, Bazley, Schroeder, Reynolds, Kent 1985). Our goal is to include the most educationally effective blend of theory and practice. Whereas practice is the main focus, we discuss accounting theory as it applies to the topics in each chapter. The textbook is organized in a fairly traditional manner. We do not feel that rearranging the order of coverage, just for the sake of being different, is sound pedagogy. On the other hand, we have chosen to expand the treatment of some topics (e.g., inflation accounting, present value, and leases) while reducing that of other topics (e.g., consolidations). We believe this blend of topics will provide a more realistic and useful introduction to accounting.

Pedagogy

Although accounting principles are sometimes difficult for elementary students, we believe they can be made more understandable and interesting by using a clear, direct, building-block discussion that anticipates a student's learning process and that is written at the student's reading level. Each chapter begins with a set of learning objectives — what the student should understand after reading the chapter — and an introduction that presents the topics to be covered. Each topic is then discussed in a logical order. Generally

each topic is introduced by a brief practical or conceptual overview, followed by a discussion of the related accounting practices. This discussion often includes the use of visuals; i.e., flowcharts, diagrams, or sets of steps designed to facilitate the student's understanding of the material. After the discussion, an example is presented to reinforce the student's learning process. Each example is straightforward, fully explained, and avoids quantum leaps that might confuse the student. Illustrations of journal entries, supporting schedules, and financial statements are abundant and meaningful. A conceptual summary concludes the discussion of many topics.

Within each chapter, headings separate the material into logically ordered, understandable portions for the student. Key definitions are **boldfaced**; *italics* are used for emphasis. Each chapter has a glossary of key terms, carefully developed to be a concise but complete reference for the student. Review problems (and solutions) are included at the ends of all chapters except Chapter 6. The accounting practices of real companies are referred to often to relate the discussion to actual practice. The 1984 annual report of the Procter & Gamble Company is included in Appendix A at the end of the text.

Coverage

The text consists of 21 chapters divided into four parts including: I. The Accounting Process, II. Accounting for Assets and Liabilities, III. Business Entities, and IV. Financial Statements: Additional Aspects of Financial Reporting. For those instructors not wishing to cover all chapters, the text is designed to allow coverage of topics in a variety of ways. For instance, the internal control, special journals, and electronic data processing topics of Chapter 6 are independent units enabling deferral or omission of one or more topics. Since partnership accounting is covered in a separate chapter (13) from corporations, it may be deleted without disruption of the remaining material. Chapters 14 and 15 on corporations may be covered after Chapter 6 for a corporate approach to the text. Because present value is discussed as a separate unit in Chapter 16, this topic and related applications may be omitted if desired. Finally, other noncurrent assets and liabilities, analysis of financial statements, and accounting for changing prices are covered in separate chapters (18, 20, and 21) so that selected coverage may be assigned.

Specific Features

In our combined 30 years of teaching experience we have identified many aspects of sound pedagogy; these have been incorporated into this textbook. Some of the major features are summarized below.

1. *Source documents.* In Part I the role of source documents is emphasized to give students a better understanding of where the information comes from for recording transactions (and for internal control). The importance of source documents is reinforced throughout the text.
2. *Nontechnical GAAP.* Broad, generally accepted accounting principles (GAAP) are

introduced and explained in Chapter 1; others are introduced and explained in later chapters as specific topics arise. GAAP is presented in an understandable nontechnical language without repeatedly quoting formal pronouncements.

3. *Revenue and expense transactions.* Discussion of revenues and expenses is deferred until Chapter 3, after a clear discussion of simple balance sheet transactions (Chapter 1) and accounts, journal entries, and postings for balance sheet transactions (Chapter 2), causing less confusion for the students.
4. *Corporations.* Parts I and II focus primarily on sole proprietorships, although many of the basic principles also apply to partnerships and corporations. Chapter 5, however, includes a section that identifies the basic accounting differences between sole proprietorships and corporations, allowing the instructor the flexibility of taking a more corporate approach throughout Part II. Partnerships and corporations are then fully discussed in Chapters 13, 14, and 15.
5. *Internal control and EDP systems.* Chapter 6 provides a comprehensive discussion of internal control, highlighting the importance and use of an efficient and effective accounting system. This includes internal control as it relates to authorizing, executing, and recording transactions, and overall accountability for assets. The EDP discussion goes beyond that in most texts by converting a manual illustration from a previous chapter to an EDP system and comparing (in nontechnical language) the differences in steps and documents.
6. *Receivables and liabilities.* Accounts receivable and notes receivable are thoroughly discussed together in Chapter 8; Current liabilities (including payroll) are also covered in one chapter (Chapter 10). This arrangement lessens the confusion often found in many texts that try to discuss the accounting principles for both receivables and payables at the same time.
7. *Income tax issues integrated.* Rather than devoting an entire chapter to the specifics of income taxes (which many instructors do not cover in an elementary course, given the complex and changeable nature of tax), a brief discussion of income tax is integrated in each chapter where it applies to specific topics (e.g., inventories and depreciation). This enables students to understand the general relationship of accounting principles and income taxes while leaving the detailed discussion of specifics to a separate tax course, often taken by both accounting and nonaccounting majors.
8. *Bonds payable and present value.* Bonds payable and the straight line method for premiums or discounts are discussed *before* present value. After present value is fully discussed, the effective interest method is described. This arrangement allows flexibility for the instructor and a more logical organization for the student.
9. *Present value concepts and techniques.* Present value is carefully introduced at an elementary level in Chapter 16 and later applied to bonds, mortgages, investments, leases, notes, and pensions, allowing a more realistic and relevant understanding of these topics.
10. *Consolidated financial statements.* In accordance with the recommendations of reviewers and a survey of elementary instructors, only the underlying concepts and basic practices of this very technical topic are presented (as part of Chapter 18), rather than devoting a full chapter to it as in many texts. The important items affecting financial statements (e.g., goodwill and minority interest) are discussed while the

complexities of preparation are not. This enables valuable class time to be devoted to other topics more appropriate for the beginning level.

11. *Inflation accounting.* Since the issuance of FASB Statement 33 and its modification by FASB Statement No. 82, accounting for changing prices is here to stay. Chapter 21 presents an elementary yet thorough discussion of this important topic, including simple examples of comprehensively restated financial statements (using both constant dollar and current cost approaches) and simple examples of the minimum disclosure requirements of FASB Statement 33 (as modified).
12. *Assignment materials.* An abundance of end-of-chapter assignment materials are included, divided into questions, exercises, problems (Part A and B), and discussion cases. A **boldfaced** note beside each assignment indicates the subject at issue. The questions address key concepts and terms; each exercise reinforces a topic at an elementary level. The problems either combine a number of topics or focus on a more in-depth study of a single topic. Many problems also require short discussion-type answers. The discussion cases require the students to integrate the topical materials.

Major Changes

Numerous changes have been made in this second edition. Several of the major changes are summarized as follows:

1. *More emphasis on the FASB conceptual framework.* The theoretical discussion in Chapter 1 has been reorganized to focus on the FASB conceptual framework, at an elementary level. The initial discussion is reinforced in later chapters.
2. *Expanded discussion of uses of balance sheet.* In Chapter 2 the discussion of the uses of the balance sheet has been expanded. Included is an introductory explanation of liquidity, financial flexibility, and capital maintenance.
3. *Expanded discussion of uses of income statement.* In Chapter 3 the discussion of the uses of the income statement has been expanded. Included is an introductory explanation of return on investment, risk, financial flexibility, and operating capability.
4. *Expansion of introduction to corporations.* In response to requests from some users, the discussion of the basic accounting differences between sole proprietorships and corporations in Chapter 5 has been slightly expanded. The chapter now contains brief discussions of the modifications of the income statement, balance sheet, and closing entries for corporations. This addition increases the flexibility of taking a sole proprietorship or a corporate approach to Part II.
5. *Modification of EDP discussion.* The EDP discussion in Chapter 6 has been extensively revised. New material has been added that briefly explains the various types of software packages, including accounts receivable, accounts payable, inventory, payroll, general ledger, and spreadsheet programs.
6. *New EDP demonstration and homework diskette.* The illustration of electronic data processing in Chapter 6 has been modified to include a demonstration diskette for an IBM personal computer so that students can “work through” the illustration. This diskette is available at no charge to instructors who adopt the text. In addition, one

exercise (E6-12) and two problems (P6-6A and P6-6B) dealing with elementary EDP accounting systems have been developed. These are also included on the diskette. Complete instructions for both the illustration and the homework are provided in an appendix to the chapter.

7. *Rearrangement of coverage of marketable securities.* In response to users' suggestions, the discussion of accounting for current marketable securities has been moved from Chapter 7 to Chapter 17. This enables an instructor to cover both current and noncurrent investments in stock in the same chapter.
8. *Expansion of accounting for notes receivable.* The discussion of short-term notes receivable in Chapter 8 has been expanded to include an explanation of the "60-day, 6%" rule and a set of steps to compute the proceeds for a note receivable discounted.
9. *Addition of LIFO perpetual inventory discussion.* The discussion of inventory systems in Chapter 9 has been expanded to include an explanation of the application of LIFO under a perpetual inventory system.
10. *Expansion of discussion of depreciation and income taxes.* Because of the potentially significant differences between depreciation for financial reporting and depreciation for income taxes, the discussion in Chapter 11 has been expanded to include an explanation of the Accelerated Cost Recovery System (ACRS).
11. *Clarification of straight-line amortization.* To aid in understanding the straight-line amortization of discounts and premiums on bonds payable, equations have been added to Chapter 16 for computing the semiannual interest payment, discount or premium amortization, and interest expense.
12. *Rearrangement of topics.* Several related topics have been combined in a new chapter. Chapter 18 includes a discussion of capital and operating leases, long-term notes payable and receivable, mortgages payable, deferred income taxes, pensions, consolidated financial statements, and international accounting. This combination allows flexibility in coverage of these topics.
13. *New discussion of international accounting.* Because of the increasing importance of understanding international business, a section on international accounting has been added to Chapter 18.
14. *Expansion of discussion of statement of changes in financial position.* The discussion in Chapter 19 has been modified in several areas. The overview of the statement has been expanded and Exhibit 19-3 has been added to clarify the sources and uses of working capital. Exhibit 19-9 has been added to illustrate the primary differences between working capital and cash sources from operations. Exhibit 19-11 has been added to illustrate the differences between revenues, expenses, and operating cash flows.
15. *Modification of financial analysis comparisons.* The section on financial analysis comparisons in Chapter 20 has been modified to add a discussion of the evaluation stage in decision making. Included is a discussion of return on investment, risk, financial flexibility, liquidity, and operating capability.
16. *Revision of discussion of inflation accounting.* The material in Chapter 21 has been rearranged and condensed to incorporate the modifications to FASB Statement No. 33 as a result of the issuance of FASB Statement No. 82.
17. *Expanded and revised homework assignments.* Additional exercises and problems

have been added to various chapters. The numbers (and solutions) have been changed in over 70 percent of the homework material.

Supplementary Materials

In addition to the textbook, several supplementary aids are available. For the student, these include:

1. A *Study Guide* prepared by Loren A. Nikolai, David Gotlob, Indiana University, Jerry Kreuze, Western Michigan University, and James W. Worthington, Auburn University. The study guide includes an outline of each chapter along with self-evaluation exercises and supplementary short-answer homework assignments, with solutions and post tests.
2. Partially completed *Working Papers* for all problems.
3. A *Checklist* of key answers to the exercises and problems.
4. Two manual *Practice Sets*, developed by Loren A. Nikolai and David Gotlob. Practice Set I, "Boone Office Supply," focusing on accounting for a sole proprietorship retailing company, is designed to be used after Chapter 6. Practice Set II, "Crockett Automotive Parts," deals with accounting for a wholesaling corporation and is to be used after Chapter 19.
5. A "*Your Name*" *Company: Accounting Practice Set for the Computer*, prepared by Thomas W. Charles and Frederic M. Stiner, University of Delaware. This practice set operates on an actual general ledger software program, and is designed to familiarize students with computers and their capabilities.

For the instructor, the supplementary aids include:

1. A *Solutions Manual* for all homework materials. The manual includes a suggested solution for each question, exercise, problem, and case, all supporting calculations, and helpful notes to the instructor concerning difficult areas within each problem. Included at the beginning of each chapter is a content analysis of the exercises and problems in that chapter. Included in the preface is a suggested assignment schedule and a list of transparencies.
2. An *Instructor's Manual* containing, for each chapter, a list of objectives, synopsis, lecture outline, general instructional notes, and a content analysis of the exercises and problems by topic.
3. A *Test Bank* of examination materials for each chapter, including true-false and multiple-choice questions, completion statements, and short-answer problems.
4. A *Computerized Test Bank* on a diskette for the IBM PC and Apple II, using the same test material appearing in the printed Test Bank.
5. A set of *Transparencies* (set in large type) for the solutions to selected homework materials. Also included are numerous "teaching visuals" for lecture purposes.
6. An *EDP Demonstration and Homework Diskette*. This diskette, for the IBM personal computer, may be copied by students for use with the EDP illustration and related homework in Chapter 6.

Acknowledgments

We wish to thank our first edition users and reviewers for their useful comments in this revision. We are particularly grateful to Joe Silviso, University of Missouri, for his constructive criticism. A special thanks is due to Bert Hurn and Steve Sutton for their valuable computer technical assistance. We also wish to thank our graduate and undergraduate students including Cecelia DiRaimo, Phyllis Parker, Jenny Reed, Laura Wolz, Elaine Martin, Kim Meyer, and Sandy Spatafora for their invaluable technical assistance in the preparation of the book and supporting materials. We are sincerely indebted to our typists, Mary Thomas, Anita Blanchar, and Lisa Copeland, whose quality work and perseverance enabled us to complete the manuscript in a timely and orderly fashion. Appreciation is also extended to our editorial and production staffs, including John B. McHugh, Nancy Crow, Tina Samaha, and Katherine Murray.

We are grateful to our respective Schools of Accountancy and to the American Institute of Certified Public Accountants, the Financial Accounting Standards Board, and the many companies for granting us permission to quote from their respective pronouncements and financial statements. We are also grateful to our wives, children, and friends who provided us with considerable moral support and understanding during the entire manuscript production process.

Loren A. Nikolai
John D. Bazley

The authors wish to express their appreciation to the individuals who served as reviewers and who provided insightful comments and valuable suggestions in the planning and writing of this textbook:

Terry L. Arndt
Ball State University
James J. Benjamin
Texas A & M University
Linda Benz
Jefferson Community College
Charles E. Birch
Cleveland State University
Robert Bracken
Rhode Island College
John T. Burke
Western Michigan
Annhenrie Campbell
Humboldt State
Pauline Corn
Virginia Poly Tech

Richard Cross
Bentley College
Robert Dailey
El Camino Community College
Joseph Doser
Truckee Meadows Community College
Dean Edmiston
Emporia State
Jack Ellis
San Jose Community College
Shirley Glass
Macomb Community College
Ellsworth C. Granger
Mankato State University
James T. Hood
Northeast Louisiana University

Robert W. Ingram
University of South Carolina

Edward J. Krohn
Miami-Dade Community College

Anthony T. Krzystofik
University of Massachusetts—Amherst

Robert Landry
Massasoit Community College

Larry Larson
Triton Community College

Robert Lipson
University of Texas at El Paso

Richard W. Lott
Bentley College

John MacArthur
University of Northern Iowa

Frank A. Mayne
University of Texas at El Paso

Paul H. Mihalek
University of Connecticut

Joseph Milligan
College of DuPage

Adolph Neidermeyer
West Virginia University

Kalo Neidert
University of Nevada

Lee Nicholas
University of Northern Iowa

Daniel J. O'Mara
Villanova University

Mary Lou Pae
Clarion University

Philip M. J. Reckers
Arizona State University

H. Lee Schlorff
Bentley College

Richard Vangermeersch
University of Rhode Island

James S. Worthington
Auburn University

Brief Contents

Part 1 The Accounting Process 1

- 1 Accounting: Its Uses, Principles, and Practices 3
- 2 Recording and Reporting Accounting Information 42
- 3 Revenues, Expenses, and the Income Statement 85
- 4 Adjusting Entries and the Worksheet 142
- 5 Accounting for a Merchandising Company 188
- 6 Internal Control, Special Journals, and EDP Systems 240

Part 2 Accounting for Assets and Liabilities 305

- 7 Cash 307
- 8 Accounts Receivable and Notes Receivable 340
- 9 Inventories and Cost of Goods Sold 376
- 10 Current Liabilities and Payrolls 422
- 11 Property, Plant, and Equipment: Acquisition and Depreciation 455
- 12 Property, Plant, and Equipment: Disposals, Intangibles, and Natural Resources 491

Part 3 Business Entities 521

- 13 Partnership Accounting 523
- 14 Corporations: Capital Stock and Contributed Capital 564
- 15 Corporations: Earnings, Retained Earnings, and Dividends 603

Part 4 Financial Statements: Additional Aspects of Financial Reporting 643

- 16 Bonds Payable and Present Value 645
- 17 Marketable Securities and Long-Term Investments 694
- 18 Other Noncurrent Assets and Liabilities 737
- 19 Statement of Changes in Financial Position 784
- 20 Analysis of Financial Statements 832
- 21 Accounting for Changing Prices 883

Appendix A A-1

Appendix B A-17

Index I-1

Contents

Part 1 The Accounting Process 1

1 Accounting: Its Uses, Principles, and Practices 3

Accounting and Decisions. Accounting Defined. Decision Making by Internal and External Users. Accounting Information and Decision Making. **The Accountancy Profession.** Public Accounting. Managerial Accounting. Governmental and Quasi-Governmental Accounting. **Emphasis of This Textbook.** Business Organizations. Accounting Versus Bookkeeping. Differences Between Financial and Managerial Accounting. **General Principles and Concepts of Financial Accounting.** Organizations Influential in Establishing GAAP. Conceptual Framework. Relevance. Reliability. Materiality. Transactions and Source Documents. Monetary Unit and Historical Cost. Entity Concept. Going Concern Concept. Diagram of General Concepts of Financial Accounting. **Financial Statements.** Income Statement. Statement of Changes in Financial Position. Balance Sheet. **Accounting Equation and Double Entry Rule.** Accounting Equation. Double Entry Rule. **Example of Recording Transactions.** **Review Problem.** **Solution to Review Problem.** **Glossary.**

2 Recording and Reporting Accounting Information 42

Accounts. Components of an Account. Debit and Credit Rules. Balance of an Account. Double Entry Rule. Checklist of Important Rules. Illustration of Rules. **General Journal and Journalizing.** General Journal. Key Procedures in Journalizing. Illustration of Journal Entries. **Accounts and Posting.** Account Formats. Account Numbers and Chart of Accounts. Summary of Posting Process and Illustration. **Trial Balance.** Error Detection. **Balance Sheet.** **Components of an Accounting System.** **Review Problem.** **Solution to Review Problem.** **Glossary.**

3 Revenues, Expenses, and the Income Statement 85

Net Income and the Income Statement. Revenues. Expenses. Accounting Principles Related to Net Income. Income Statement. **Withdrawals.** **Relationship of Net Income and Withdrawals to Owner's Equity.** **Recording, Retaining, and Reporting Net Income and Withdrawals Information.** Debit and Credit Rules. Recording and Posting Transactions. Chart of Accounts and Account Titles. Illustration of Accounting for Withdrawals, Revenues, and Expenses. Adjusting Entries. Adjusted Trial Balance. Financial Statements. **Closing Entries.**

Closing the Revenue Accounts. Closing the Expense Accounts. Closing the Income Summary Account. Closing the Withdrawals Account. Illustration of Complete Closing and Posting Process. Post-Closing Trial Balance. Summary of Closing Process. **The Accounting Process.** **Review Problem.** **Solution to Review Problem.** **Glossary.**

4 Adjusting Entries and the Worksheet 142

Adjusting Entries. Apportionment of Depreciable Assets. Apportionment of Prepaid Expenses. Apportionment of Unearned Revenues. Recording of Accrued Expenses. Recording of Accrued Revenues. Summary of Adjusting Entries. **Worksheet.** Preparation of Trial Balance (Step 1). Preparation of Worksheet Adjustments (Step 2). Preparation of Adjusted Trial Balance (Step 3). Preparation of Worksheet Financial Statements (Step 4). Checking for Errors. Completing the Accounting Process from the Worksheet. **Reversing Entries.** **Summary of Accounting Process.** **Review Problem.** **Solution to Review Problem.** **Glossary.**

5 Accounting for a Merchandising Company 188

Sales. Sales Revenues. Sales Returns and Allowances. Sales Discounts. Net Sales. **Cost of Goods Sold.** Perpetual Inventory System. Periodic Inventory System. **Classified Financial Statements.** Classified Income Statement. Classified Balance Sheet. **Closing Entries.** Cost of Goods Sold Closing Entries (Periodic System). Remaining Closing Entries. **Worksheet for Merchandising Company.** **Review Problem.** **Solution to Review Problem.** **Glossary.**

6 Internal Control, Special Journals, and EDP Systems 240

Internal Control. Authorization for Transactions. Execution of Transactions. Recording of Transactions. Accountability for Assets. Internal Control Principles. Diagram of Internal Control. Limitations of Internal Control. **Special Journals.** Sales Journal. Purchases Journal. Cash Receipts Journal. Cash Payments Journal. General Journal. Modifications in Special Journals. Advantages of Special Journals (with Subsidiary Ledgers). **Electronic Data Processing.** Hardware. Software. Illustration of Electronic Data Processing. Internal Control for an EDP System. **Chapter Appendix: Using a Personal Computer for Applications of an EDP Accounting System.** Copying Instructor's Diskette. **Demonstration Problem.** Instructions for E6-12, P6-6A, and P6-6B. **Glossary.**

Part 2 Accounting for Assets and Liabilities 305

7 Cash 307

Cash. **Internal Control of Cash.** Establishing Responsibilities. Maintaining Good Records. Separation of Duties. Mechanical Devices and Established Routines. Physical Safety and Insurance. Cash Received from Cash Sales.

Cash Received by Mail. Cash Payments. Voucher System. Voucher Register. Check Register. Vouchers Unpaid and Vouchers Paid Files. **Petty Cash Fund.** **Bank Reconciliation.** Causes of the Difference. Procedures for Preparing a Bank Reconciliation. Illustration of a Bank Reconciliation. **Interest-Bearing Accounts.** **Disclosure of Cash.** **Review Problem.** **Solution to Review Problem.** **Glossary.**

8 Accounts Receivable and Notes Receivable 340

Credit Sales and Collections. **Uncollectible Accounts Receivable.** How Should the Uncollectibility Be Recognized in the Income Statement? When Should the Uncollectibility Be Recognized? Recognition of Bad Debt Expense. Write-Off of an Uncollectible Account. The Direct Write-Off Method. **Measurement of the Bad Debt Expense.** Percent of Sales Method of Estimating Bad Debt Expense. Aging Method of Estimating Bad Debt Expense. Recovery of Accounts Written Off. Summary of Percent of Sales and Aging Methods. **Credit Card Sales.** **Notes Receivable.** Promissory Note. General Rule for Computing Interest and the Maturity Date. Interest on Accounts Receivable. Dishonored Notes Receivable. **Discounting a Note Receivable.** Maturity of a Discounted Note Receivable. Disclosure of Accounts and Notes Receivable in the Financial Statements. **Review Problem.** **Solution to Review Problem.** **Glossary.**

9 Inventories and Cost of Goods Sold 376

The Importance of Inventory. **Alternative Inventory Systems.** Periodic Inventory System. Perpetual Inventory System. Differences Between the Periodic and Perpetual Inventory Systems. Evaluation of the Two Methods. Taking a Physical Inventory. Items in Transit and on Consignment. **Determination of the Cost of Inventory.** Purchases Discounts: The Gross Method. Purchases Discounts: The Net Method. Implications for Management. Trade Discounts. **Inventory Cost Flow Assumptions.** Specific Identification. First-In, First-Out. Average Cost. Last-In, First-Out (Periodic). Last-In, First-Out (Perpetual). Additional Periodic Illustration. **Evaluation of the Three Alternatives.** Effects on Financial Statements. Liquidation of LIFO Layers. Impact of Tax Rules. Income Measurement. **Lower of Cost or Market Rule.** **Methods of Estimating Inventory Costs.** Gross Profit Method. Retail Inventory Method. **Errors in Recording Inventory.** **Disclosure in the Financial Statements.** **Review Problem.** **Solution to Review Problem.** **Glossary.**

10 Current Liabilities and Payrolls 422

Purchasing on Credit. Accounts Payable. **Unearned Revenue and Accrued Liabilities.** Unearned Revenue. Premiums and Coupons. Warranties. Sales Tax. Property Taxes. Income Taxes. Cash Dividends. **Notes Payable.** Note Given to Make a Purchase or Extend Payment Time on an Account Payable. Note Given to Borrow Money from a Bank. Comparison of the Two Types of Loans. **Payroll Accounting.** Federal and State Income Taxes. Federal Social Security Taxes. Federal and State Unemployment Taxes. Other Employee Deductions. **Recording the Payroll.** Payroll Register. Recording the Journal Entry for the

Payroll. Payroll Taxes Paid by the Employer. **Review Problem.** **Solution to Review Problem.** **Glossary.**

11 Property, Plant, and Equipment: Acquisition and Depreciation 455

Characteristics of Property, Plant, and Equipment. **Acquisition Cost of Property, Plant, and Equipment.** Types of Property, Plant, and Equipment. Illustration of Accounting for Acquisition Cost. Acquisition Cost in a Lump-Sum Purchase. Acquisition by Self-Construction. **Depreciation.** Straight-Line Depreciation. Effects of Depreciation on the Financial Statements. Causes of Depreciation. Service Life and Residual Value. Allocation of Cost Not Valuation. Systematic and Rational Allocation of Costs. Declining-Charge Depreciation Methods. Activity Depreciation Methods. **Additional Depreciation Considerations.** Depreciation and Fractional Periods. Depreciation and Income Taxes. Depreciation and the Replacement of an Asset. Revision of Estimates. **Subsequent Expenditures.** Capital Expenditures. Revenue Expenditures. **Disclosure in the Financial Statements.** **Review Problem.** **Solution to Review Problem.** **Glossary.**

12 Property, Plant, and Equipment: Disposals, Intangibles, and Natural Resources 491

Disposals of Property, Plant, and Equipment. Disposal of a Fully Depreciated Asset with No Cash Proceeds. Sale at an Amount Equal to the Residual Value. Sale Above Book Value (Gain). Sale Below Book Value (Loss). Sale Before the End of the Estimated Service Life. Exchange of Property, Plant, and Equipment. Federal Income Tax and the Exchange of Similar Productive Assets. **Intangible Assets.** Research and Development Costs. Patents. Copyrights. Trademarks and Tradenames. Franchises. Organization Costs. Leases and Leasehold Improvements. Amortization of Intangibles. Goodwill. **Natural Resource Assets.** Method of Computing Depletion Expense. Revised Estimates of Productive Capacity. Cost Depletion and Percentage Depletion. **Review Problem.** **Solution to Review Problem.** **Glossary.**

Part 3 Business Entities 521

13 Partnership Accounting 523

Characteristics of a Partnership. Partnership Agreement. General and Limited Partners. Unlimited Liability. Income Tax. Voluntary Association. Mutual Agency. Limited Life. **Reasons for the Formation of a Partnership.** **Accounting for Partnership Equity.** Capital and Withdrawals Account for Each Partner. **Partnership Earnings.** Earnings Divided According to a Set Ratio. Interest Provided on Capital. Recognition of Salaries for Partners. Salaries and Interest. **Financial Statements of a Partnership.** Income Statement. Balance Sheet. Statement of Changes in Partners' Equity. **Admission of a New Partner.** New