

Accountants' Guidebook

A Financial and Managerial Accounting Reference

Second Edition

Steven M. Bragg

Table of Contents

Chapter 1 – The Role of the Accountant.....	1
Learning Objectives	1
Introduction.....	1
The Accountancy Concept.....	1
Financial and Managerial Accounting.....	3
Types of Accountants	4
Responsibilities of the Accounting Department.....	5
Customer-oriented Responsibilities	5
Supplier-oriented Responsibilities	5
Employee-oriented Responsibilities.....	5
Financial Statements	6
Analysis.....	6
Organizational Structure of the Accounting Department	7
Summary.....	9
Review Questions.....	10
Review Answers	11
Chapter 2 – The Chart of Accounts	12
Learning Objectives	12
Introduction.....	12
Overview of the Chart of Accounts	12
Assets	12
Liabilities.....	13
Stockholders' Equity	13
Revenue.....	13
Expenses.....	13
The Three-Digit Chart of Accounts	13
The Five-Digit Chart of Accounts.....	15
The Seven-Digit Chart of Accounts	16
Chart of Accounts Reduction.....	19
Alphanumeric Account Coding	20
Summary.....	21
Review Questions.....	22
Review Answers	23
Chapter 3 – The General Ledger and Trial Balance	24
Learning Objectives	24
Introduction.....	24
The Ledger Concept	24
General Ledger Overview	25
The Accounts Receivable Ledger.....	26
The Purchase Ledger	27
Overview of the Trial Balance	28
The Trial Balance Format.....	28
The Extended Trial Balance.....	29
Trial Balance Error Correction.....	30
The Post-Closing Trial Balance.....	30
Evaluation of the Trial Balance.....	31
Summary.....	31
Review Questions.....	32
Review Answers	33
Chapter 4 – Accounting Procedures.....	34
Learning Objectives	34

Table of Contents

Introduction.....	34
The Nature of a Procedure.....	34
The Need for Procedures.....	34
The Number of Procedures to Develop	35
The Mechanics of Procedure Production.....	36
Procedure Production Steps	36
Formatting Steps	37
Procedure Design Tips	38
Dissemination of Procedures	39
Procedural Updates	40
Enforcement of Procedures.....	40
“Carrot” Activities	40
“Stick” Activities	41
Deviations from Procedures.....	41
Presented Procedures	42
The Credit Examination Procedure (Manual System)	42
The Shipping Procedure (Manual System).....	47
The Billing Procedure.....	50
The Check Receipts Processing Procedure	54
The Purchasing Procedure	57
The Supplier Invoice Processing Procedure (Manual System).....	61
The Check Payment Issuance Procedure	64
Summary.....	67
Review Questions.....	68
Review Answers	69
Chapter 5 – Accounting for Receivables.....	70
Learning Objectives	70
Introduction.....	70
Accounting for Billings.....	70
Accounting for Sales Taxes.....	71
The Allowance for Doubtful Accounts.....	72
Notes Receivable.....	74
Acquisition, Development, and Construction Arrangements.....	75
Nonrefundable Fees and Other Costs	77
Loans and Debt Securities Acquired with Deteriorated Credit Quality	79
Troubled Debt Restructurings by Creditors.....	80
Receivables Presentation	81
Receivables Disclosures	82
Summary.....	86
Review Questions.....	87
Review Answers	88
Chapter 6 – Accounting for Investments.....	89
Learning Objectives	89
Introduction.....	89
Overview of Investments – Debt and Equity Securities	89
Accounting for Investments.....	89
Impairment of Investments.....	90
Restricted Stock.....	91
Dividend and Interest Income.....	91
The Equity Method.....	92
Investment Disclosures	94
Summary.....	96
Review Questions.....	97
Review Answers	98

Table of Contents

Chapter 7 – Accounting for Inventory	99
Learning Objectives	99
Introduction.....	99
Overview of Inventory	99
The Periodic Inventory System.....	101
The Perpetual Inventory System	102
Inventory Costing.....	102
The First In, First Out Method.....	102
The Last In, First Out Method.....	103
The Weighted Average Method.....	105
Standard Costing	106
The Retail Inventory Method	107
The Gross Profit Method.....	108
Overhead Allocation.....	109
The Lower of Cost or Market Rule.....	111
Work in Process Accounting	112
Accounting for Obsolete Inventory	113
Consignment Accounting	114
Goods in Transit	114
Inventory Disclosures.....	115
Summary.....	115
Review Questions.....	116
Review Answers	117
 Chapter 8 – Accounting for Property, Plant, and Equipment	 118
Learning Objectives	118
Introduction.....	118
Overview of Fixed Assets.....	118
Initial Fixed Asset Recognition	119
Fixed Assets Acquired through a Business Combination	120
Nonmonetary Exchanges.....	120
Depreciation and Amortization	123
Straight-Line Method.....	124
Sum-of-the-Years’ Digits Method.....	124
Double-Declining Balance Method	125
Depletion Method.....	126
Units of Production Method.....	128
Land Depreciation.....	128
Land Improvement Depreciation	128
Depreciation Accounting Entries	129
Fixed Asset Impairment	130
Fixed Asset Disposal	132
Assets Held for Sale	132
Abandoned Assets.....	136
Idle Assets.....	136
Fixed Asset Disposal Accounting	136
Fixed Asset Disclosures.....	137
General Fixed Asset Disclosures.....	137
Change in Estimate Disclosures.....	138
Intangible Asset Impairment Disclosures	138
Intangible Asset Disclosures	139
Summary.....	140
Review Questions.....	141
Review Answers	142
 Chapter 9 – Accounting for Intangibles.....	 143
Learning Objectives	143

Table of Contents

Introduction.....	143
Goodwill	143
General Intangibles Other than Goodwill	146
Internal-Use Software	148
Website Development Costs	149
Intangibles Disclosures	150
Summary	152
Review Questions.....	154
Review Answers	155
Chapter 10 – Accounting for Equity	156
Learning Objectives	156
Introduction.....	156
Overview of Equity	156
Stock Dividends and Stock Splits	156
Stock Dividend.....	157
Stock Split	157
Treasury Stock	157
Purchase of Treasury Stock	158
Resale of Treasury Stock.....	158
Cost Method	158
Constructive Retirement Method	159
Equity-Based Payments to Non-Employees	159
Initial Recognition	159
Spinoffs and Reverse Spinoffs	161
Equity Disclosures	162
Rights and Privileges	162
Preferred Stock.....	162
Contingently Convertible Securities.....	162
Redeemable Securities.....	163
Treasury Stock.....	163
Changes in Shareholders' Equity	163
Equity-Based Payments to Non-Employees	163
Summary.....	163
Review Questions.....	164
Review Answers	165
Chapter 11 – Revenue Recognition	166
Learning Objectives	166
Introduction.....	166
Topic 606, Revenue from Contracts with Customers	166
The Nature of a Customer.....	166
Steps in Revenue Recognition	167
Step One: Link Contract to Customer.....	167
Step Two: Note Performance Obligations.....	169
Step Three: Determine Prices	171
Variable Consideration.....	171
Possibility of Reversal	172
Time Value of Money	173
Noncash Consideration.....	175
Payments to Customers.....	176
Refund Liabilities	176
Step Four: Allocate Prices to Obligations	177
Allocation of Price Discounts.....	178
Allocation of Variable Consideration.....	179
Subsequent Price Changes.....	179
Step Five: Recognize Revenue.....	180
Measurement of Progress Completion	181

Table of Contents

Output Methods	181
Input Methods	182
Change in Estimate	183
Progress Measurement	183
Right of Return	183
Consistency	184
Contract Modifications	184
Treatment as Separate Contract	184
Treatment as Continuing Contract	185
Entitlement to Payment	186
Bill-and-Hold Arrangements	187
Consideration Received from a Supplier	188
Customer Acceptance	189
Customer Options for Additional Purchases	190
Licensing	191
Nonrefundable Upfront Fees	193
Principal versus Agent	193
Repurchase Agreements	194
Unexercised Rights of Customers	196
Warranties	196
Contract-Related Costs	197
Costs to Obtain a Contract	197
Costs to Fulfill a Contract	198
Amortization of Costs	199
Impairment of Costs	199
Exclusions	199
Revenue Disclosures	200
Summary	203
Review Questions	204
Review Answers	205
Chapter 12 – Accounting for Payroll.....	207
Learning Objectives	207
Introduction.....	207
The Chart of Accounts	207
Types of Payroll Journal Entries.....	208
Primary Payroll Journal Entry.....	209
Accrued Wages	210
Accrued Bonuses.....	210
Accrued Commissions	211
Benefit Payments.....	212
Accrued Benefits.....	212
Stock Subscriptions	213
Manual Paycheck Entry	213
Employee Advances	214
Accrued Vacation Pay.....	215
Tax Deposits.....	216
Payroll Information in the Financial Statements – Wages	216
Payroll Information in the Financial Statements – Payroll Taxes.....	216
Summary	217
Review Questions.....	218
Review Answers	219
Chapter 13 – Accounting for Stock-Based Compensation.....	220
Learning Objectives	220
Introduction.....	220
Overview of Stock Compensation	220
The Volatility Concept.....	223

Table of Contents

Fair Value Calculation Alternatives	223
Awards Classified as Equity	225
Award Measurement Problems	225
Contingent Features	225
Award Modifications	225
Income Tax Effects	226
Awards Classified as Liabilities	226
Employee Share Purchase Plans	228
Stock-Based Compensation Disclosures	228
Summary	230
Review Questions	231
Review Answers	232
Chapter 14 – Accounting for Income Taxes	233
Learning Objectives	233
Introduction	233
Overview of Income Taxes	233
Accounting for Income Taxes	235
Tax Positions	235
Deferred Tax Expense	236
Applicable Tax Rate	236
Interest and Penalties	237
Intraperiod Tax Allocation	237
Taxes Related to Undistributed Earnings	238
Interim Reporting	238
Income Taxes Presentation	240
Income Taxes Disclosure	241
Balance Sheet	241
Income Statement	241
Other	242
Summary	243
Review Questions	244
Review Answers	245
Chapter 15 – Accounting for Business Combinations	246
Learning Objectives	246
Introduction	246
Overview of Business Combinations	246
Identifiable Assets and Liabilities, and Noncontrolling Interests	247
Goodwill or Gain from Bargain Purchase	249
Goodwill Calculation	249
Bargain Purchase	250
Reverse Acquisitions	250
Related Issues	252
Acquisition of Assets	252
Transactions between Entities under Control of Same Parent	252
Pushdown Accounting	253
Income Taxes	253
Business Combination Disclosures	254
General Disclosures	254
Identifiable Assets and Liabilities, and any Noncontrolling Interest	255
Goodwill or Gain from Bargain Purchase	256
Reverse Acquisitions	256
Transactions between Entities under Control of Same Parent	257
Income Taxes	257
Summary	257
Review Questions	258
Review Answers	259

Table of Contents

Chapter 16 – Foreign Currency Matters	260
Learning Objectives	260
Introduction.....	260
Foreign Currency Transactions	260
Financial Statement Translation.....	261
Determination of Functional Currency	261
Translation of Financial Statements	262
Use of Average Exchange Rates.....	264
Hyperinflationary Effects	264
Derecognition of a Foreign Entity Investment	264
Foreign Currency Disclosures	265
Summary.....	265
Review Questions.....	266
Review Answers	267
Chapter 17 – Accounting for Leases	268
Learning Objectives	268
Introduction.....	268
Overview of Leases	268
Capital Lease Criteria	268
Lease Classification by Lessor	270
Lease Reassessment	270
Accounting for Leasehold Improvements.....	271
Special Lease Terms	271
Operating Leases	272
Operating Lease Treatment by Lessee.....	272
Operating Lease Treatment by Lessor	272
Capital Leases.....	272
Capital Lease Treatment by Lessee	273
Capital Lease Treatment of Sublease by Lessee.....	273
Capital Lease Treatment by Lessor (Sales-Type Lease).....	274
Capital Lease Treatment by Lessor (Direct Financing Lease)	274
Capital Lease Treatment by Lessor (Leveraged Lease).....	276
Capital Lease Treatment by Lessor (Broadly Applicable).....	276
Sale-Leaseback Transactions	276
Sale-Leaseback Treatment by Lessee	277
Sale-Leaseback Treatment by Lessor	278
Lease Disclosures	278
Lessee Disclosures.....	278
Lessor Disclosures.....	279
Summary.....	280
Review Questions.....	282
Review Answers	283
Chapter 18 – Accounting Changes and Error Corrections.....	284
Learning Objectives	284
Introduction.....	284
Changes in Accounting Principle.....	284
Changes in Accounting Estimate.....	285
Changes in Reporting Entity.....	285
Correction of an Error in Previously Issued Financial Statements	285
Corrections Related to Prior Interim Periods.....	285
The Materiality of an Error.....	286
Accounting Changes and Error Corrections Disclosures.....	286
Change in Accounting Principle.....	286
Change in Accounting Estimate	287
Change in Reporting Entity	287
Error Corrections	287

Table of Contents

Historical Summaries	287
Summary	289
Review Questions	290
Review Answers	291
Chapter 19 – Closing the Books	292
Learning Objectives	292
Introduction.....	292
Prior Steps: Update Reserves.....	292
Core Steps: Issue Customer Invoices	293
Core Steps: Value Inventory	294
Core Steps: Calculate Depreciation.....	296
Core Steps: Create Accruals.....	298
Core Steps: Consolidate Division Results.....	299
Core Steps: Eliminate Intercompany Transactions	299
Core Steps: Review Journal Entries	299
Core Steps: Reconcile Accounts	300
Core Steps: Close Subsidiary Ledgers	301
Core Steps: Create Financial Statements.....	302
Core Steps: Review Financial Statements.....	302
Core Steps: Accrue Tax Liabilities.....	302
Core Steps: Close the Month	303
Core Steps: Add Disclosures	303
Core Steps: Write Cover Letter	303
Core Steps: Issue Financial Statements.....	304
Delayed Steps: Issue Customer Invoices	305
Delayed Steps: Closing Metrics.....	305
Delayed Steps: Document Future Closing Changes	305
Delayed Steps: Update Closing Procedures.....	306
Summary	306
Review Questions.....	307
Review Answers	308
Chapter 20 – The Financial Statements	309
Learning Objectives	309
Introduction.....	309
The Income Statement.....	309
Income Statement Overview	309
The Single-Step Income Statement.....	311
The Multi-Step Income Statement	312
The Condensed Income Statement	313
The Contribution Margin Income Statement	313
The Multi-Period Income Statement	314
How to Construct the Income Statement	315
The Balance Sheet	316
Overview of the Balance Sheet	316
The Common Size Balance Sheet.....	318
The Comparative Balance Sheet.....	319
How to Construct the Balance Sheet.....	320
The Statement of Cash Flows	322
Overview of the Statement of Cash Flows	322
The Direct Method	323
The Indirect Method	324
How to Prepare the Statement of Cash Flows	325
The Statement of Retained Earnings.....	326
Overview of the Statement of Retained Earnings.....	327
How to Prepare the Statement of Retained Earnings.....	327
Summary	328

Table of Contents

Review Questions	329
Review Answers	330
Chapter 21 – Public Company Financial Reporting	331
Learning Objectives	331
Introduction.....	331
Interim Reporting	331
The Integral View.....	331
The Discrete View.....	332
Comparison of the Integral and Discrete Views	332
Interim Reporting Issues	333
Segment Reporting.....	333
Primary Segment Reporting Issues	333
The Segment Report.....	335
Earnings per Share.....	336
Basic Earnings per Share.....	336
Diluted Earnings per Share	337
Presentation of Earnings per Share.....	340
The Public Company Closing Process.....	340
The Form 10-Q	341
The Form 10-K	342
Summary.....	344
Review Questions.....	345
Review Answers	346
Chapter 22 – Management Reports	347
Learning Objectives	347
Introduction.....	347
The Duration of a Report.....	347
Responsibility Reporting	347
The Flash Report	348
Related to Cash	348
Related to Sales	348
Related to Bottlenecks	348
Related to Customer Service	348
Expense Reporting	349
Margin Reporting	350
Variance Reporting	353
The Purchase Price Variance.....	353
Material Yield Variance	354
Labor Rate Variance	355
Labor Efficiency Variance.....	355
Variable Overhead Spending Variance.....	356
Variable Overhead Efficiency Variance	357
Fixed Overhead Spending Variance.....	357
Selling Price Variance.....	358
Sales Volume Variance.....	358
Problems with Variance Analysis.....	359
Which Variances to Report.....	359
How to Report Variances	360
Summary.....	361
Review Questions.....	362
Review Answers	363
Chapter 23 – Cash Receipts Management.....	364
Learning Objectives	364
Introduction.....	364
Check Receipts	364

Table of Contents

Check Receipt Improvements	365
The Bank Lockbox	365
Automatic Cash Application	367
Mailstop Number.....	367
Remote Deposit Capture.....	368
Cash Receipts	368
Cash Receipts Improvements	369
Credit Card Receipts.....	369
Credit Card Receipt Improvements	370
Enter Information in On-line Form Immediately.....	370
On-line Payment Apps	370
Debit Cards.....	371
Summary.....	371
Review Questions.....	372
Review Answers	373
Chapter 24 – Collection Tactics	374
Learning Objectives	374
Introduction.....	374
Overview of Collection Tactics	374
Collection Tactics.....	375
Courtesy Calls	375
Grace Period Reduction.....	375
Dunning Letters	376
Check Payment by Fax or E-mail	377
Pay Undisputed Line Items	377
Confirm Payment Date.....	378
Take Back Merchandise.....	378
Hold Orders	378
ACH Debits.....	378
Split Payments.....	379
Postdated Checks.....	379
Interest and Penalties	379
Promissory Note	379
Salesperson Assistance.....	380
COD Roll	380
Barter	381
Arbitration	381
Attorney Letters	381
Final Demand Letter	381
Issue Small Claims Court Complaint	382
The Collection Reputation.....	382
Credit Repayments.....	382
The Collection Call.....	383
Preparation.....	383
Scheduling.....	383
Phone Skills.....	383
Escalation.....	384
Documentation.....	384
Collect in Person.....	384
Summary.....	385
Review Questions.....	386
Review Answers	387
Chapter 25 – Payroll Management.....	388
Learning Objectives	388
Introduction.....	388
Payroll Cycle Duration	388

Table of Contents

Streamlined Timekeeping	390
Electronic Payments	391
Employee Self-Service.....	391
Manager Self-Service	391
Transaction Error Analysis	392
Staff Training Program.....	392
The Payroll Calendar	393
Information Confidentiality.....	394
Summary	395
Review Questions.....	396
Review Answers	397
Chapter 26 – Budgeting.....	398
Learning Objectives	398
Introduction.....	398
The System of Budgets.....	398
The Reasons for Budget Iterations.....	401
Overview of the Revenue Budget.....	401
The Ending Finished Goods Inventory Budget.....	403
The Production Budget	405
Production Budgeting for Multiple Products.....	407
The Direct Materials Budget (Roll up Method)	407
The Direct Materials Budget (Historical Method).....	409
The Direct Labor Budget.....	410
The Manufacturing Overhead Budget.....	410
The Sales and Marketing Budget	411
Diminishing Returns Analysis.....	413
The Research and Development Budget.....	414
The Administration Budget.....	415
The Compensation Budget	417
The Budgeted Income Statement.....	419
The Budgeted Balance Sheet	420
Accounts Receivable	420
Inventory.....	422
Fixed Assets	423
Accounts Payable	423
Additional Estimation Elements.....	424
The Cash Line Item.....	425
The Financing Budget.....	425
The Compiled Balance Sheet.....	427
Summary	428
Review Questions.....	429
Review Answers	430
Chapter 27 – Capital Budgeting	431
Learning Objectives	431
Introduction.....	431
Overview of Capital Budgeting	431
Bottleneck Analysis.....	432
Net Present Value Analysis.....	432
The Payback Method.....	434
Capital Budget Proposal Analysis	435
The Outsourcing Decision.....	436
The Capital Budgeting Application Form	437
The Post Installation Review.....	438
The Lease versus Buy Decision	439
Summary.....	440

Table of Contents

Review Questions	441
Review Answers	442
Chapter 28 – Business Ratios.....	443
Learning Objectives	443
Introduction.....	443
What to Measure	443
Measurement Consistency.....	444
Measurement Timing	444
Deflated Sales Growth	445
Sales per Person	445
Deflated Profit Growth.....	446
Profit per Person.....	447
Core Earnings Ratio.....	448
Breakeven Point	448
Margin of Safety.....	449
Current Ratio	450
Quick Ratio.....	451
Working Capital Productivity	451
Debt to Equity Ratio	452
Interest Coverage Ratio	453
Cost per Square Foot.....	453
Occupancy Cost Ratio	454
Return on Equity	455
Days Sales Outstanding.....	457
Best Possible DSO	458
Collection Effectiveness Index	458
Inventory Turnover.....	459
Sales Productivity	460
Sales Backlog Ratio.....	460
Customer Turnover.....	461
Summary.....	462
Review Questions.....	463
Review Answers	464
Chapter 29 – Cost Object Analysis.....	465
Learning Objectives	465
Introduction.....	465
Factors in Cost Object Analysis.....	465
The Assignability of Costs.....	466
The Customer Cost Object.....	467
Customer Acquisition Costs	468
Customer Lifetime Value.....	468
The Employee Cost Object	469
The Product Cost Object.....	470
The Product Line Cost Object	471
The Sales Channel Cost Object	472
Cost Object Termination Issues	473
Which Cost Objects to Track.....	473
Summary.....	474
Review Questions.....	475
Review Answers	476
Glossary.....	477
Index	485