

# **Accountants' Guidebook**

---

**5<sup>th</sup> Edition**

**Steven M. Bragg**

# Table of Contents

---

<b>Chapter 1 – The Role of the Accountant.....</b>	<b>1</b>
Learning Objectives .....	1
Introduction.....	1
The Accountancy Concept .....	1
Financial and Managerial Accounting .....	3
Types of Accountants .....	3
Responsibilities of the Accounting Department.....	4
Customer-Oriented Responsibilities .....	5
Supplier-Oriented Responsibilities .....	5
Employee-Oriented Responsibilities.....	5
Financial Statements .....	5
Analysis .....	6
Organizational Structure of the Accounting Department .....	6
Summary.....	8
Review Questions.....	9
Review Answers .....	10
 <b>Chapter 2 – The Chart of Accounts .....</b>	 <b>11</b>
Learning Objectives .....	11
Introduction.....	11
Overview of the Chart of Accounts .....	11
Assets .....	11
Liabilities.....	12
Stockholders' Equity .....	12
Revenue .....	12
Expenses.....	12
The Three-Digit Chart of Accounts .....	12
The Five-Digit Chart of Accounts.....	14
The Seven-Digit Chart of Accounts .....	15
Chart of Accounts Reduction.....	18
Alphanumeric Account Coding .....	19
Summary.....	19
Review Questions.....	20
Review Answers .....	21
 <b>Chapter 3 – The General Ledger and Trial Balance .....</b>	 <b>23</b>
Learning Objectives .....	23
Introduction.....	23
The Ledger Concept .....	23
General Ledger Overview .....	24
The Accounts Receivable Ledger.....	25
The Purchase Ledger .....	26
Overview of the Trial Balance .....	27
The Trial Balance Format.....	27
The Extended Trial Balance .....	28
Trial Balance Error Correction .....	29
The Post-Closing Trial Balance .....	29
Evaluation of the Trial Balance.....	30
Summary.....	30
Review Questions.....	31
Review Answers .....	32
 <b>Chapter 4 – Accounting Procedures.....</b>	 <b>33</b>
Learning Objectives .....	33
Introduction.....	33

## Table of Contents

The Nature of a Procedure.....	33
The Need for Procedures.....	33
The Number of Procedures to Develop .....	34
The Mechanics of Procedure Production.....	35
Procedure Production Steps .....	35
Formatting Steps .....	36
Procedure Design Tips .....	36
Dissemination of Procedures .....	38
Procedural Updates .....	38
Enforcement of Procedures.....	39
“Carrot” Activities .....	39
“Stick” Activities .....	39
Deviations from Procedures.....	40
Presented Procedures .....	40
The Credit Examination Procedure (Manual System) .....	41
The Shipping Procedure (Manual System).....	44
The Billing Procedure.....	48
The Check Receipts Processing Procedure .....	52
The Purchasing Procedure .....	55
The Supplier Invoice Processing Procedure (Manual System).....	59
The Check Payment Issuance Procedure .....	61
Summary.....	65
Review Questions.....	66
Review Answers .....	67
<b>Chapter 5 – Accounting for Receivables.....</b>	<b>69</b>
Learning Objectives .....	69
Introduction.....	69
Accounting for Billings.....	69
Accounting for Sales Taxes.....	70
Accounting for Use Taxes .....	72
The Allowance for Doubtful Accounts.....	73
Notes Receivable.....	75
Acquisition, Development, and Construction Arrangements.....	76
Nonrefundable Fees and Other Costs .....	77
Receivables Presentation .....	80
Summary.....	80
Review Questions.....	81
Review Answers .....	82
<b>Chapter 6 – Accounting for Investments.....</b>	<b>83</b>
Learning Objectives .....	83
Introduction.....	83
Overview of Investments – Debt and Equity Securities .....	83
Accounting for Investments .....	83
Impairment of Investments.....	84
Restricted Stock.....	85
Dividend and Interest Income.....	85
Credit Losses.....	85
The Equity Method.....	86
Summary.....	88
Review Questions.....	89
Review Answers .....	90
<b>Chapter 7 – Accounting for Inventory .....</b>	<b>91</b>
Learning Objectives .....	91
Introduction.....	91
Overview of Inventory .....	91

## Table of Contents

The Periodic Inventory System.....	93
The Perpetual Inventory System .....	93
Inventory Costing.....	94
The First In, First Out Method .....	94
The Last In, First Out Method.....	95
The Weighted Average Method.....	97
Standard Costing .....	97
The Retail Inventory Method .....	99
The Gross Profit Method .....	99
Overhead Allocation.....	100
The Lower of Cost or Market Rule.....	102
Work in Process Accounting .....	104
Accounting for Obsolete Inventory .....	104
Consignment Accounting .....	105
Goods in Transit .....	106
Summary.....	106
Review Questions.....	107
Review Answers .....	108
<b>Chapter 8 – Accounting for Property, Plant, and Equipment .....</b>	<b>109</b>
Learning Objectives .....	109
Introduction.....	109
Overview of Fixed Assets.....	109
Initial Fixed Asset Recognition .....	110
Fixed Assets Acquired through a Business Combination .....	111
Nonmonetary Exchanges.....	111
Depreciation and Amortization .....	114
Straight-Line Method.....	115
Sum-of-the-Years' Digits Method .....	115
Double-Declining Balance Method .....	116
Depletion Method.....	117
Units of Production Method.....	118
Land Depreciation.....	119
Land Improvement Depreciation .....	119
Depreciation Accounting Entries .....	120
Fixed Asset Impairment .....	121
Fixed Asset Disposal .....	123
Assets Held for Sale .....	123
Abandoned Assets.....	126
Idle Assets.....	126
Fixed Asset Disposal Accounting .....	127
Summary.....	128
Review Questions.....	129
Review Answers .....	130
<b>Chapter 9 – Accounting for Intangibles.....</b>	<b>131</b>
Learning Objectives .....	131
Introduction.....	131
Goodwill .....	131
General Intangibles Other than Goodwill .....	134
Internal-Use Software .....	136
Internal-Use Software Accessed via a Hosting Arrangement .....	138
Website Development Costs .....	139
Summary.....	139
Review Questions.....	140
Review Answers .....	141

## Table of Contents

<b>Chapter 10 – Accounting for Equity .....</b>	<b>143</b>
Learning Objectives .....	143
Introduction.....	143
Overview of Equity.....	143
The Sale of Stock .....	143
Dividend Payments.....	144
Stock Dividends and Stock Splits .....	144
Stock Dividend.....	145
Stock Split .....	145
Treasury Stock .....	145
Purchase of Treasury Stock.....	146
Resale of Treasury Stock.....	146
Cost Method .....	146
Constructive Retirement Method .....	147
Equity-Based Payments to Non-Employees .....	147
Initial Recognition .....	147
Spinoffs and Reverse Spinoffs .....	149
Summary .....	149
Review Questions.....	151
Review Answers .....	152
<b>Chapter 11 – Revenue Recognition .....</b>	<b>153</b>
Learning Objectives .....	153
Introduction.....	153
Topic 606, Revenue from Contracts with Customers .....	153
The Nature of a Customer.....	153
Steps in Revenue Recognition .....	154
Step One: Link Contract to Customer.....	154
Step Two: Note Performance Obligations.....	156
Step Three: Determine Prices .....	158
Variable Consideration.....	158
Possibility of Reversal.....	159
Time Value of Money .....	160
Noncash Consideration.....	162
Payments to Customers.....	163
Refund Liabilities .....	163
Step Four: Allocate Prices to Obligations .....	163
Allocation of Price Discounts.....	165
Allocation of Variable Consideration.....	166
Subsequent Price Changes.....	166
Step Five: Recognize Revenue .....	166
Measurement of Progress Completion .....	168
Output Methods .....	168
Input Methods.....	169
Change in Estimate .....	169
Progress Measurement.....	170
Right of Return .....	170
Consistency .....	171
Contract Modifications .....	171
Treatment as Separate Contract .....	171
Treatment as Continuing Contract.....	171
Entitlement to Payment.....	173
Bill-and-Hold Arrangements .....	173
Consideration Received from a Supplier .....	174
Customer Acceptance.....	176
Customer Options for Additional Purchases .....	176
Licensing .....	178
Nonrefundable Upfront Fees .....	179

## Table of Contents

Principal versus Agent .....	179
Repurchase Agreements .....	180
Unexercised Rights of Customers .....	182
Warranties .....	182
Contract-Related Costs .....	183
Costs to Obtain a Contract .....	183
Costs to Fulfill a Contract .....	184
Amortization of Costs .....	185
Impairment of Costs .....	185
Exclusions .....	185
Revenue Disclosures .....	186
Summary .....	189
Review Questions .....	190
Review Answers .....	191
<b>Chapter 12 – Accounting for Payroll.....</b>	<b>193</b>
Learning Objectives .....	193
Introduction .....	193
The Chart of Accounts .....	193
Types of Payroll Journal Entries .....	194
Primary Payroll Journal Entry .....	194
Accrued Wages .....	195
Accrued Bonuses .....	196
Accrued Commissions .....	197
Benefit Payments .....	197
Accrued Benefits .....	198
Stock Subscriptions .....	199
Manual Paycheck Entry .....	199
Employee Advances .....	199
Accrued Vacation Pay .....	200
Tax Deposits .....	201
Payroll Information in the Financial Statements – Wages .....	201
Payroll Information in the Financial Statements – Payroll Taxes .....	201
Summary .....	202
Review Questions .....	203
Review Answers .....	204
<b>Chapter 13 – Accounting for Stock-Based Compensation.....</b>	<b>205</b>
Learning Objectives .....	205
Introduction .....	205
Overview of Stock Compensation .....	205
The Volatility Concept .....	208
Fair Value Calculation Alternatives .....	208
Awards Classified as Equity .....	210
Award Measurement Problems .....	210
Contingent Features .....	210
Award Modifications .....	210
Income Tax Effects .....	211
Awards Classified as Liabilities .....	211
Employee Share Purchase Plans .....	212
Summary .....	213
Review Questions .....	214
Review Answers .....	215
<b>Chapter 14 – Accounting for Income Taxes .....</b>	<b>217</b>
Learning Objectives .....	217
Introduction .....	217
Overview of Income Taxes .....	217

## Table of Contents

Accounting for Income Taxes.....	218
Tax Positions .....	219
Deferred Tax Expense .....	220
Applicable Tax Rate.....	220
Interest and Penalties .....	220
Intraperiod Tax Allocation .....	221
Taxes Related to Undistributed Earnings .....	221
Interim Reporting .....	222
Income Taxes Presentation.....	224
Income Taxes Disclosure.....	224
Balance Sheet .....	224
Income Statement.....	225
Other .....	225
Summary.....	226
Review Questions.....	227
Review Answers .....	228
<b>Chapter 15 – Accounting for Business Combinations.....</b>	<b>229</b>
Learning Objectives .....	229
Introduction.....	229
Overview of Business Combinations .....	229
Identifiable Assets and Liabilities, and Noncontrolling Interests .....	230
Goodwill or Gain from Bargain Purchase.....	232
Goodwill Calculation .....	232
Bargain Purchase .....	233
Reverse Acquisitions .....	234
Related Issues.....	235
Acquisition of Assets.....	235
Transactions between Entities under Control of Same Parent .....	235
Pushdown Accounting .....	236
Income Taxes .....	236
Business Combination Disclosures .....	237
General Disclosures.....	237
Identifiable Assets and Liabilities, and any Noncontrolling Interest.....	238
Goodwill or Gain from Bargain Purchase.....	239
Reverse Acquisitions .....	239
Transactions between Entities under Control of Same Parent .....	240
Income Taxes.....	240
Summary.....	240
Review Questions.....	241
Review Answers .....	242
<b>Chapter 16 – Foreign Currency Matters .....</b>	<b>243</b>
Learning Objectives .....	243
Introduction.....	243
Foreign Currency Transactions .....	243
Financial Statement Translation.....	244
Determination of Functional Currency .....	244
Translation of Financial Statements .....	245
Use of Average Exchange Rates .....	247
Hyperinflationary Effects .....	247
Derecognition of a Foreign Entity Investment .....	247
Foreign Currency Disclosures .....	247
Summary.....	248
Review Questions.....	249
Review Answers .....	250

## Table of Contents

<b>Chapter 17 – Accounting Changes and Error Corrections .....</b>	<b>251</b>
Learning Objectives .....	251
Introduction.....	251
Changes in Accounting Principle.....	251
Changes in Accounting Estimate.....	252
Changes in Reporting Entity.....	252
Correction of an Error in Previously Issued Financial Statements .....	252
Corrections Related to Prior Interim Periods.....	252
The Materiality of an Error.....	253
Accounting Changes and Error Corrections Disclosures.....	253
Change in Accounting Principle.....	253
Change in Accounting Estimate .....	254
Change in Reporting Entity .....	254
Error Corrections .....	254
Historical Summaries .....	254
Summary .....	255
Review Questions.....	256
Review Answers .....	257
<b>Chapter 18 – Closing the Books .....</b>	<b>259</b>
Learning Objectives .....	259
Introduction.....	259
Prior Steps: Update Reserves.....	259
Core Steps: Issue Customer Invoices .....	260
Core Steps: Value Inventory .....	261
Core Steps: Calculate Depreciation.....	263
Core Steps: Create Accruals .....	265
Core Steps: Consolidate Division Results.....	266
Core Steps: Eliminate Intercompany Transactions .....	266
Core Steps: Review Journal Entries .....	266
Core Steps: Reconcile Accounts .....	266
Core Steps: Close Subsidiary Ledgers .....	268
Core Steps: Create Financial Statements.....	268
Core Steps: Review Financial Statements.....	269
Core Steps: Accrue Tax Liabilities.....	269
Core Steps: Close the Month .....	269
Core Steps: Add Disclosures .....	270
Core Steps: Write Cover Letter .....	270
Core Steps: Issue Financial Statements.....	271
Delayed Steps: Issue Customer Invoices .....	271
Delayed Steps: Closing Metrics.....	271
Delayed Steps: Document Future Closing Changes .....	272
Delayed Steps: Update Closing Procedures.....	272
Summary .....	273
Review Questions.....	274
Review Answers .....	275
<b>Chapter 19 – The Financial Statements.....</b>	<b>277</b>
Learning Objectives .....	277
Introduction.....	277
The Income Statement.....	277
Income Statement Overview .....	277
The Single-Step Income Statement.....	279
The Multi-Step Income Statement.....	280
The Condensed Income Statement.....	280
The Contribution Margin Income Statement .....	281
The Multi-Period Income Statement .....	282
How to Construct the Income Statement .....	282

## Table of Contents

The Balance Sheet .....	284
Overview of the Balance Sheet .....	284
The Common Size Balance Sheet .....	286
The Comparative Balance Sheet.....	287
How to Construct the Balance Sheet.....	288
The Statement of Cash Flows .....	290
Overview of the Statement of Cash Flows .....	290
The Direct Method .....	290
The Indirect Method.....	291
How to Prepare the Statement of Cash Flows.....	292
The Statement of Retained Earnings.....	294
Overview of the Statement of Retained Earnings .....	294
How to Prepare the Statement of Retained Earnings.....	295
Summary.....	295
Review Questions.....	296
Review Answers .....	297
<b>Chapter 20 – Public Company Financial Reporting .....</b>	<b>299</b>
Learning Objectives .....	299
Introduction.....	299
Interim Reporting .....	299
The Integral View.....	299
The Discrete View.....	300
Comparison of the Integral and Discrete Views .....	300
Interim Reporting Issues .....	301
Segment Reporting.....	301
Primary Segment Reporting Issues .....	301
The Segment Report.....	303
Earnings per Share .....	303
Basic Earnings per Share .....	303
Diluted Earnings per Share .....	304
Presentation of Earnings per Share.....	307
The Public Company Closing Process.....	308
The Form 10-Q .....	309
The Form 10-K .....	310
Summary.....	311
Review Questions.....	313
Review Answers .....	314
<b>Chapter 21 – Management Reports .....</b>	<b>315</b>
Learning Objectives .....	315
Introduction.....	315
The Duration of a Report.....	315
Responsibility Reporting .....	315
The Flash Report.....	316
Related to Cash.....	316
Related to Sales .....	316
Related to Bottlenecks .....	316
Related to Customer Service .....	316
Expense Reporting .....	317
Margin Reporting .....	318
Variance Reporting .....	321
The Purchase Price Variance.....	321
Material Yield Variance .....	322
Labor Rate Variance .....	323
Labor Efficiency Variance .....	323
Variable Overhead Spending Variance.....	324
Variable Overhead Efficiency Variance .....	325

## Table of Contents

Fixed Overhead Spending Variance.....	325
Selling Price Variance .....	326
Sales Volume Variance.....	327
Problems with Variance Analysis .....	327
Which Variances to Report .....	328
How to Report Variances .....	329
Summary.....	329
Review Questions.....	330
Review Answers .....	331
<b>Chapter 22 – Cash Receipts Management.....</b>	<b>333</b>
Learning Objectives .....	333
Introduction.....	333
Check Receipts .....	333
Check Receipt Improvements .....	334
The Bank Lockbox .....	334
Automatic Cash Application .....	336
Mailstop Number.....	336
Remote Deposit Capture.....	336
Cash Receipts .....	337
Cash Receipts Improvements .....	338
Credit Card Receipts.....	338
Credit Card Receipt Improvements .....	339
Enter Information in Online Form Immediately.....	339
Online Payment Apps .....	339
Debit Cards .....	339
Summary.....	340
Review Questions.....	341
Review Answers .....	342
<b>Chapter 23 – Collection Tactics .....</b>	<b>343</b>
Learning Objectives .....	343
Introduction.....	343
Overview of Collection Tactics .....	343
Collection Tactics.....	344
Courtesy Calls .....	344
Grace Period Reduction.....	344
Dunning Letters .....	345
Check Payment by Fax or Email .....	346
Pay Undisputed Line Items .....	346
Confirm Payment Date.....	346
Take Back Merchandise.....	347
Hold Orders .....	347
ACH Debits.....	347
Split Payments.....	348
Postdated Checks.....	348
Interest and Penalties .....	348
Promissory Note .....	348
Salesperson Assistance.....	349
COD Roll .....	349
Barter .....	350
Arbitration .....	350
Attorney Letters .....	350
Final Demand Letter .....	350
Issue Small Claims Court Complaint .....	351
The Collection Reputation.....	351
Credit Repayments .....	351
The Collection Call.....	352

## Table of Contents

Preparation .....	352
Scheduling .....	352
Phone Skills .....	352
Escalation .....	353
Documentation .....	353
Collect in Person .....	353
Summary .....	354
Review Questions .....	355
Review Answers .....	356
<b>Chapter 24 – Payroll Management.....</b>	<b>357</b>
Learning Objectives .....	357
Introduction.....	357
Payroll Cycle Duration .....	357
Streamlined Timekeeping .....	359
Electronic Payments .....	360
Employee Self-Service.....	360
Manager Self-Service .....	360
Transaction Error Analysis .....	361
Staff Training Program.....	361
The Payroll Calendar .....	362
Information Confidentiality.....	363
Summary .....	364
Review Questions .....	365
Review Answers .....	366
<b>Chapter 25 – Budgeting.....</b>	<b>367</b>
Learning Objectives .....	367
Introduction.....	367
The System of Budgets.....	367
The Reasons for Budget Iterations.....	370
Overview of the Revenue Budget.....	370
The Ending Finished Goods Inventory Budget.....	372
The Production Budget .....	374
Production Budgeting for Multiple Products .....	376
The Direct Materials Budget (Roll up Method) .....	376
The Direct Materials Budget (Historical Method).....	378
The Direct Labor Budget.....	379
The Manufacturing Overhead Budget.....	379
The Sales and Marketing Budget .....	380
Diminishing Returns Analysis.....	382
The Research and Development Budget.....	383
The Administration Budget.....	384
The Compensation Budget .....	386
The Budgeted Income Statement.....	388
The Budgeted Balance Sheet .....	389
Accounts Receivable .....	389
Inventory.....	391
Fixed Assets .....	391
Accounts Payable .....	392
Additional Estimation Elements.....	393
The Cash Line Item .....	393
The Financing Budget.....	394
The Compiled Balance Sheet.....	395
Summary .....	396
Review Questions .....	397
Review Answers .....	398

## Table of Contents

<b>Chapter 26 – Capital Budgeting .....</b>	<b>399</b>
Learning Objectives .....	399
Introduction.....	399
Overview of Capital Budgeting .....	399
Bottleneck Analysis.....	400
Net Present Value Analysis.....	400
The Payback Method .....	402
Capital Budget Proposal Analysis .....	403
The Outsourcing Decision.....	404
The Capital Budgeting Application Form .....	404
The Post Installation Review .....	406
The Lease versus Buy Decision.....	407
Summary.....	408
Review Questions.....	409
Review Answers .....	410
 <b>Chapter 27 – Business Ratios.....</b>	 <b>411</b>
Learning Objectives .....	411
Introduction.....	411
What to Measure .....	411
Measurement Consistency.....	412
Measurement Timing .....	412
Deflated Sales Growth .....	413
Sales per Person .....	413
Deflated Profit Growth.....	414
Profit per Person.....	415
Core Earnings Ratio.....	415
Breakeven Point .....	416
Margin of Safety.....	417
Current Ratio .....	418
Quick Ratio.....	418
Working Capital Productivity .....	419
Debt to Equity Ratio.....	420
Interest Coverage Ratio .....	421
Cost per Square Foot.....	421
Occupancy Cost Ratio .....	422
Return on Equity .....	423
Days Sales Outstanding.....	425
Best Possible DSO .....	426
Collection Effectiveness Index .....	426
Inventory Turnover.....	427
Sales Productivity .....	427
Sales Backlog Ratio.....	428
Customer Turnover.....	429
Summary.....	430
Review Questions.....	431
Review Answers .....	432
 <b>Chapter 28 – Cost Object Analysis .....</b>	 <b>433</b>
Learning Objectives .....	433
Introduction.....	433
Factors in Cost Object Analysis.....	433
The Assignability of Costs.....	434
The Customer Cost Object.....	435
Customer Acquisition Costs .....	436
Customer Lifetime Value.....	436
The Employee Cost Object .....	437
The Product Cost Object.....	438

## Table of Contents

The Product Line Cost Object .....	439
The Sales Channel Cost Object .....	440
Cost Object Termination Issues .....	441
Which Cost Objects to Track .....	441
Summary .....	442
Review Questions .....	443
Review Answers .....	444
<b>Glossary .....</b>	<b>445</b>
<b>Index .....</b>	<b>451</b>