

Contents

CHAPTER 1

Accounting and the Business Environment 26

Why Is Accounting Important? 28

- Decision Makers: The Users of Accounting Information 28
- The Accounting Profession 29

What Are the Organizations and Rules That Govern Accounting? 31

- Governing Organizations 31
- Generally Accepted Accounting Principles 31
- The Economic Entity Assumption 32
- The Cost Principle 32
- The Going Concern Assumption 33
- The Monetary Unit Assumption 33
- International Financial Reporting Standards 33
- Ethics in Accounting and Business 33

What Is the Accounting Equation? 35

- Assets 35
- Liabilities 35
- Equity 35

How Do You Analyze a Transaction? 36

- Transaction Analysis for Smart Touch Learning 37

How Do You Prepare Financial Statements? 42

- Income Statement 42
- Statement of Owner's Equity 43
- Balance Sheet 44
- Statement of Cash Flows 45

How Do You Use Financial Statements to Evaluate Business Performance? 47

- Green Mountain Coffee Roasters, Inc. 47
- Return on Assets (ROA) 47

■ Review 50

■ Assess Your Progress 57

■ Critical Thinking 79

CHAPTER 2

Recording Business Transactions 86

What Is an Account? 88

- Assets 88
- Liabilities 89
- Equity 90
- Chart of Accounts 90
- Ledger 91

What Is Double-Entry Accounting? 92

- The T-Account 92
- Increases and Decreases in the Accounts 92
- Expanding the Rules of Debit and Credit 93
- The Normal Balance of an Account 93
- Determining the Balance of a T-Account 94

How Do You Record Transactions? 95

- Source Documents—The Origin of the Transactions 95
- Journalizing and Posting Transactions 96
- The Ledger Accounts After Posting 107
- The Four-Column Account: An Alternative to the T-Account 109

What Is the Trial Balance? 111

- Preparing Financial Statements From the Trial Balance 111
- Correcting Trial Balance Errors 112

How Do You Use the Debt Ratio to Evaluate Business Performance? 113

■ Review 116

■ Assess Your Progress 124

■ Critical Thinking 152

CHAPTER 3

The Adjusting Process 156

What Is the Difference Between Cash Basis Accounting and Accrual Basis Accounting? 158

What Concepts and Principles Apply to Accrual Basis Accounting? 160

- The Time Period Concept 160
- The Revenue Recognition Principle 160
- The Matching Principle 161

What Are Adjusting Entries and How Do We Record Them? 162

- Prepaid Expenses 163
- Unearned Revenues 169
- Accrued Expenses 170
- Accrued Revenues 174

What Is the Purpose of the Adjusted Trial Balance and How Do We Prepare It? 178

What Is the Impact of Adjusting Entries on the Financial Statements? 180

How Could a Worksheet Help in Preparing Adjusting Entries and the Adjusted Trial Balance? 181

APPENDIX 3A: Alternative Treatment of Recording Prepaid Expenses and Unearned Revenues 184

What Is an Alternative Treatment of Recording Prepaid Expenses and Unearned Revenues? 184

- Prepaid Expenses 184
- Unearned Revenues 185

■ Review 187

■ Assess Your Progress 196

■ Critical Thinking 222

CHAPTER 4

Completing the Accounting Cycle 230

How Do We Prepare Financial Statements? 232

- Relationships Among the Financial Statements 233

How Could a Worksheet Help in Preparing Financial Statements? 237

- Section 5—Income Statement 237
- Section 6—Balance Sheet 237
- Section 7—Determine Net Income or Net Loss 237

What Is the Closing Process, and How Do We Close the Accounts? 239

- Closing Temporary Accounts—Net Income 241
- Closing Temporary Accounts—Net Loss 243

How Do We Prepare a Post-Closing Trial Balance? 245

What Is the Accounting Cycle? 247

How Do We Use the Current Ratio to Evaluate Business Performance? 248

APPENDIX 4A: Reversing Entries: An Optional Step 250

What Are Reversing Entries? 250

Accounting for Accrued Expenses 250

Accounting Without a Reversing Entry 251

Accounting With a Reversing Entry 252

■ Review 254

■ Assess Your Progress 264

■ Critical Thinking 292

Comprehensive Problem 1 for Chapters 1–4 295

Comprehensive Problem 2 for Chapters 1–4 297

CHAPTER 5

Merchandising Operations 300

What Are Merchandising Operations? 302

The Operating Cycle of a Merchandising Business 302

Merchandise Inventory Systems: Perpetual and Periodic Inventory Systems 304

How Are Purchases of Merchandise Inventory Recorded in a Perpetual Inventory System? 305

Purchase of Merchandise Inventory 306

Purchase Discounts 307

Purchase Returns and Allowances 308

Transportation Costs 310

Cost of Inventory Purchased 311

How Are Sales of Merchandise Inventory Recorded in a Perpetual Inventory System? 312

Sale of Merchandise Inventory 312

Sales Discounts 314

Sales Returns and Allowances 315

Transportation Costs—Freight Out 316

Net Sales Revenue and Gross Profit 317

What Are the Adjusting and Closing Entries for a Merchandiser? 318

Adjusting Merchandise Inventory Based on a Physical Count 318

Closing the Accounts of a Merchandiser 319

Worksheet for a Merchandising Business—Perpetual Inventory System 319

How Are a Merchandiser's Financial Statements Prepared? 322

Income Statement 322

Statement of Owner's Equity and the Balance Sheet 324

How Do We Use the Gross Profit Percentage to Evaluate Business Performance? 324

APPENDIX 5A: Accounting for Merchandise Inventory in a Periodic Inventory System 326

How Are Merchandise Inventory Transactions Recorded in a Periodic Inventory System? 326

Purchase of Merchandise Inventory 326

Sale of Merchandise Inventory 328

Adjusting and Closing Entries 328

Preparing Financial Statements 331

■ Review 336

■ Assess Your Progress 348

■ Critical Thinking 377

Comprehensive Problem for Chapters 1–5 381

CHAPTER 6

Merchandise Inventory 386

What Are the Accounting Principles and Controls That Relate to Merchandise Inventory? 388

Accounting Principles 388

Control Over Merchandise Inventory 389

How Are Merchandise Inventory Costs Determined Under a Perpetual Inventory System? 390

Specific Identification Method 392

First-In, First-Out (FIFO) Method 393

Last-In, First-Out (LIFO) Method 394

Weighted-Average Method 397

How Are Financial Statements Affected by Using Different Inventory Costing Methods? 399

Income Statement 400

Balance Sheet 400

How Is Merchandise Inventory Valued When Using the Lower-of-Cost-or-Market Rule? 403

Computing the Lower-of-Cost-or-Market 403

Recording the Adjusting Journal Entry to Adjust Merchandise Inventory 403

What Are the Effects of Merchandise Inventory Errors on the Financial Statements? 405

How Do We Use Inventory Turnover and Days' Sales in Inventory to Evaluate Business Performance? 408

Inventory Turnover 408

Days' Sales in Inventory 408

APPENDIX 6A: Merchandise Inventory Costs Under a Periodic Inventory System 409

How Are Merchandise Inventory Costs Determined Under a Periodic Inventory System? 409

First-In, First-Out (FIFO) Method 411

Last-In, First-Out (LIFO) Method 411

Weighted-Average Method 411

APPENDIX 6B: Estimating Ending Merchandise Inventory 413

How Can the Cost of Ending Merchandise Inventory Be Estimated? 413

Gross Profit Method 413

The Retail Method 414

■ Review 416

■ Assess Your Progress 425

■ Critical Thinking 445

CHAPTER 7

Accounting Information Systems 452

What Is an Accounting Information System? 454

Effective Accounting Information Systems 454

Components of an Accounting Information System 455

Contents

How Are Sales and Cash Receipts Recorded in a Manual Accounting Information System? 457

- Special Journals 458
- Subsidiary Ledgers 458
- The Sales Journal 459
- The Cash Receipts Journal 462

How Are Purchases, Cash Payments, and Other Transactions Recorded in a Manual Accounting Information System? 466

- The Purchases Journal 466
- The Cash Payments Journal 468
- The General Journal 471

How Are Transactions Recorded in a Computerized Accounting Information System? 473

- Entry-Level Software 473
- Enterprise Resource Planning (ERP) Systems 473
- QuickBooks® 473
- Review 478
- Assess Your Progress 484
- Critical Thinking 510
- Comprehensive Problem for Chapters 1–7 513

CHAPTER 8

Internal Control and Cash 516

What Is Internal Control and How Can It Be Used to Protect a Company's Assets? 518

- Internal Control and the Sarbanes-Oxley Act 518
- The Components of Internal Control 519
- Internal Control Procedures 520
- The Limitations of Internal Control—Costs and Benefits 523

What Are the Internal Control Procedures With Respect to Cash Receipts? 524

- Cash Receipts Over the Counter 524
- Cash Receipts by Mail 524

What Are the Internal Control Procedures With Respect to Cash Payments? 525

- Controls Over Payment by Check 525

How Can a Petty Cash Fund Be Used for Internal Control Purposes? 528

- Setting Up the Petty Cash Fund 528
- Replenishing the Petty Cash Fund 529
- Changing the Amount of the Petty Cash Fund 531

How Can the Bank Account Be Used as a Control Device? 532

- Signature Card 532
- Deposit Ticket 532
- Check 532
- Bank Statement 533
- Electronic Funds Transfer 534
- Bank Reconciliation 534
- Examining a Bank Reconciliation 537
- Journalizing Transactions From the Bank Reconciliation 538

How Can the Cash Ratio Be Used to Evaluate Business Performance? 539

- Review 541
- Assess Your Progress 550
- Critical Thinking 568

CHAPTER 9

Receivables 572

What Are Common Types of Receivables and How Are Credit Sales Recorded? 574

- Types of Receivables 574
- Exercising Internal Control Over Receivables 575
- Recording Sales on Credit 575
- Recording Credit Card and Debit Card Sales 576
- Factoring and Pledging Receivables 578

How Are Uncollectibles Accounted for When Using the Direct Write-Off Method? 579

- Recording and Writing Off Uncollectible Accounts—Direct Write-Off Method 579
- Recovery of Accounts Previously Written Off—Direct Write-Off Method 580
- Limitations of the Direct Write-Off Method 580

How Are Uncollectibles Accounted for When Using the Allowance Method? 581

- Recording Bad Debts Expense—Allowance Method 581
- Writing Off Uncollectible Accounts—Allowance Method 582
- Recovery of Accounts Previously Written Off—Allowance Method 583
- Estimating and Recording Bad Debts Expense—Allowance Method 584
- Comparison of Accounting for Uncollectibles 589

How Are Notes Receivable Accounted For? 591

- Identifying Maturity Date 592
- Computing Interest on a Note 593
- Accruing Interest Revenue and Recording Honored Notes Receivable 593
- Recording Dishonored Notes Receivable 596

How Do We Use the Acid-Test Ratio, Accounts Receivable Turnover Ratio, and Days' Sales in Receivables to Evaluate Business Performance? 596

- Acid-Test (or Quick) Ratio 597
- Accounts Receivable Turnover Ratio 598
- Days' Sales in Receivables 598

- Review 600
- Assess Your Progress 607
- Critical Thinking 627

CHAPTER 10

Plant Assets, Natural Resources, and Intangibles 632

How Does a Business Measure the Cost of a Plant Asset? 634

- Land and Land Improvements 635
- Buildings 636
- Machinery and Equipment 636
- Furniture and Fixtures 637
- Lump-Sum Purchase 637
- Capital and Revenue Expenditures 638

What Is Depreciation and How Is It Computed? 640

- Factors in Computing Depreciation 640
- Depreciation Methods 641
- Partial-Year Depreciation 647
- Changing Estimates of a Depreciable Asset 647
- Reporting Plant Assets 648

How Are Disposals of Plant Assets Recorded? 649

- Discarding Plant Assets 649
- Selling Plant Assets 651

How Are Natural Resources Accounted For? 656

How Are Intangible Assets Accounted For? 657

Accounting for Intangibles 657

Specific Intangibles 657

Reporting of Intangible Assets 660

How Do We Use the Asset Turnover Ratio to Evaluate Business Performance? 661

APPENDIX 10A: Exchanging Plant Assets 662

How Are Exchanges of Plant Assets Accounted For? 662

Exchange of Plant Assets—Gain Situation 662

Exchange of Plant Assets—Loss Situation 663

■ Review 665

■ Assess Your Progress 671

■ Critical Thinking 684

CHAPTER 11

Current Liabilities and Payroll 688

How Are Current Liabilities of Known Amounts Accounted For? 690

Accounts Payable 690

Sales Tax Payable 691

Unearned Revenues 691

Short-Term Notes Payable 692

Current Portion of Long-Term Notes Payable 693

How Do Companies Account for and Record Payroll? 694

Gross Pay and Net (Take-Home) Pay 695

Employee Payroll Withholding Deductions 695

Payroll Register 698

Journalizing Employee Payroll 699

Employer Payroll Taxes 699

Internal Control Over Payroll 701

How Are Current Liabilities That Must Be Estimated Accounted For? 702

Bonus Plans 702

Vacation, Health, and Pension Benefits 703

Warranties 703

How Are Contingent Liabilities Accounted For? 705

Remote Contingent Liability 706

Reasonably Possible Contingent Liability 706

Probable Contingent Liability 706

How Do We Use the Times-Interest-Earned Ratio to Evaluate Business Performance? 708

■ Review 710

■ Assess Your Progress 717

■ Critical Thinking 730

CHAPTER 12

Partnerships 734

What Are the Characteristics and Types of Partnerships? 736

Partnership Characteristics 736

Types of Partnerships 738

Other Forms of Business 739

How Are Partnerships Organized? 741

The Start-up of a Partnership 741

Partnership Financial Statements 742

How Are Partnership Profits and Losses Allocated? 742

Allocation Based on a Stated Ratio 743

Allocation Based on Capital Balances 744

Allocation Based on Services, Capital Balances, and Stated Ratios 744

Partner Withdrawal of Cash and Other Assets 747

Statement of Partners' Equity 748

How Is the Admission of a Partner Accounted For? 749

Admission by Purchasing an Existing Partner's Interest 749

Admission by Contributing to the Partnership 750

How Is the Withdrawal of a Partner Accounted For? 753

How Is the Liquidation of a Partnership Accounted For? 755

Sales of Assets at a Gain 755

Sales of Assets at a Loss With Capital Deficiency 759

■ Review 763

■ Assess Your Progress 771

■ Critical Thinking 792

CHAPTER 13

Corporations 798

What Is a Corporation? 800

Characteristics of Corporations 800

Stockholders' Equity Basics 801

How Is the Issuance of Stock Accounted For? 804

Issuing Common Stock at Par Value 804

Issuing Common Stock at Premium 805

Issuing Common Stock at a Discount 806

Issuing No-Par Common Stock 806

Issuing Stated Value Common Stock 807

Issuing Common Stock for Assets Other Than Cash 807

Issuing Preferred Stock 808

How Are Dividends and Stock Splits Accounted For? 809

Cash Dividends 809

Stock Dividends 812

Stock Splits 816

Cash Dividends, Stock Dividends, and Stock Splits Compared 817

How Is Treasury Stock Accounted For? 818

Treasury Stock Basics 818

Purchase of Treasury Stock 818

Sale of Treasury Stock 819

Retirement of Stock 822

How Is Equity Reported for a Corporation? 823

Statement of Retained Earnings 823

Statement of Stockholders' Equity 824

How Do We Use Stockholders' Equity Ratios to Evaluate Business Performance? 825

Earnings per Share 825

Price/Earnings Ratio 826

Rate of Return on Common Stock 826

■ Review 828

■ Assess Your Progress 836

■ Critical Thinking 855

CHAPTER 14

Long-Term Liabilities 862

How Are Long-Term Notes Payable and Mortgages Payable Accounted For? 864

- Long-Term Notes Payable 864
- Mortgages Payable 865

What Are Bonds? 868

- Types of Bonds 869
- Bond Prices 869
- Present Value 870
- Bond Interest Rates 871
- Bond Financing Versus Issuing Stock 872

How Are Bonds Payable Accounted for Using the Straight-Line Amortization Method? 873

- Issuing Bonds Payable at Face Value 873
- Issuing Bonds Payable at a Discount 874
- Issuing Bonds Payable at a Premium 876

How Is Retirement of Bonds Payable Accounted For? 879

- Retirement of Bonds at Maturity 879
- Retirement of Bonds Before Maturity 879

How Are Liabilities Reported on the Balance Sheet? 881

How Do We Use the Debt to Equity Ratio to Evaluate Business Performance? 883

APPENDIX 14A: The Time Value of Money 884

What Is the Time Value of Money, and How Is the Present Value of a Future Amount Calculated? 884

- Time Value of Money Concepts 884
- Present Value of a Lump Sum 887
- Present Value of an Annuity 887
- Present Value of Bonds Payable 888

APPENDIX 14B: Effective-Interest Method of Amortization 890

How Are Bonds Payable Accounted for Using the Effective-Interest Amortization Method? 890

- Effective-Interest Amortization for a Bond Discount 890
- Effective-Interest Amortization of a Bond Premium 891

■ Review 894

■ Assess Your Progress 900

■ Critical Thinking 914

CHAPTER 15

Investments 920

Why Do Companies Invest? 922

- Debt Securities Versus Equity Securities 922
- Reasons to Invest 922
- Classification and Reporting of Investments 923

How Are Investments in Debt Securities Accounted For? 925

- Purchase of Debt Securities 925
- Interest Revenue 925
- Disposition at Maturity 925

How Are Investments in Equity Securities Accounted For? 926

- Equity Securities With Less Than 20% Ownership (Cost Method) 926
- Equity Securities With 20% or More, But Less Than 50%, Ownership (Equity Method) 927
- Equity Securities With 50% or More Ownership (Consolidations) 930

How Are Debt and Equity Securities Reported? 931

- Trading Investments 931
- Available-for-Sale Investments 932
- Held-to-Maturity Investments 934

How Do We Use the Rate of Return on Total Assets to Evaluate Business Performance? 935

■ Review 937

■ Assess Your Progress 943

■ Critical Thinking 952

CHAPTER 16

The Statement of Cash Flows 956

What Is the Statement of Cash Flows? 958

- Purpose of the Statement of Cash Flows 958
- Classification of Cash Flows 959
- Two Formats for Operating Activities 961

How Is the Statement of Cash Flows Prepared Using the Indirect Method? 961

- Cash Flows From Operating Activities 964
- Cash Flows From Investing Activities 968
- Cash Flows From Financing Activities 970
- Net Change in Cash and Cash Balances 974
- Non-cash Investing and Financing Activities 975

How Do We Use Free Cash Flow to Evaluate Business Performance? 977

APPENDIX 16A: Preparing the Statement of Cash Flows by the Direct Method 977

How Is the Statement of Cash Flows Prepared Using the Direct Method? 977

- Cash Flows From Operating Activities 978

APPENDIX 16B: Preparing the Indirect Statement of Cash Flows Using a Spreadsheet 984

How Is the Statement of Cash Flows Prepared Using the Indirect Method and a Spreadsheet? 984

■ Review 988

■ Assess Your Progress 995

■ Critical Thinking 1026

CHAPTER 17

Financial Statement Analysis 1032

How Are Financial Statements Used to Analyze a Business? 1034

- Purpose of Analysis 1034
- Tools of Analysis 1034
- Corporate Financial Reports 1035

How Do We Use Horizontal Analysis to Analyze a Business? 1037

- Horizontal Analysis of the Income Statement 1038
- Horizontal Analysis of the Balance Sheet 1038
- Trend Analysis 1039

How Do We Use Vertical Analysis to Analyze a Business? 1041

- Common-Size Statements 1043
- Benchmarking 1044

How Do We Use Ratios to Analyze a Business? 1045

- Evaluating the Ability to Pay Current Liabilities 1047
- Evaluating the Ability to Sell Merchandise Inventory and Collect Receivables 1049
- Evaluating the Ability to Pay Long-Term Debt 1052
- Evaluating Profitability 1054
- Evaluating Stock as an Investment 1057
- Red Flags in Financial Statement Analyses 1059

APPENDIX 17A: The Corporate Income Statement 1062

How Is the Complete Corporate Income Statement Prepared? 1062

- Continuing Operations 1063
- Discontinued Operations 1064
- Extraordinary Items 1064
- Earnings per Share 1065

■ Review 1066

■ Assess Your Progress 1074

■ Critical Thinking 1096

- Comprehensive Problem for Chapter 17 1099

CHAPTER 18

Introduction to Managerial Accounting 1102

Why Is Managerial Accounting Important? 1104

- Financial Versus Managerial Accounting 1104
- Management Accountability 1105
- Today's Business Environment 1106
- Ethical Standards 1107

How Do Service, Merchandising, and Manufacturing Companies Differ? 1109

- Service Companies 1109
- Merchandising Companies 1109
- Manufacturing Companies 1110

How Are Costs Classified? 1112

- Direct and Indirect Costs 1112
- Product Costs 1113
- Prime and Conversion Costs 1113

How Do Manufacturing Companies Determine the Cost of Manufactured Products? 1115

- Calculating Cost of Goods Sold 1115
- Calculating Cost of Goods Manufactured 1115
- Flow of Costs Through the Inventory Accounts 1118
- Calculating Unit Product Cost 1119

How Is Managerial Accounting Used in Service and Merchandising Companies? 1121

- Calculating Cost per Service 1121
- Calculating Cost per Item 1121

■ Review 1122

■ Assess Your Progress 1129

■ Critical Thinking 1149

CHAPTER 19

Job Order Costing 1154

How Do Manufacturing Companies Use Job Order and Process Costing Systems? 1156

- Job Order Costing 1157
- Process Costing 1157

How Do Materials and Labor Costs Flow Through the Job Order Costing System? 1157

- Materials 1158
- Labor 1162

How Do Overhead Costs Flow Through the Job Order Costing System? 1164

- Before the Period—Calculating the Predetermined Overhead Allocation Rate 1165
- During the Period—Allocating Overhead 1166
- At the End of the Period—Adjusting for Overallocated and Underallocated Overhead 1168

What Happens When Products Are Completed and Sold? 1169

- Transferring Costs to Finished Goods Inventory 1169
- Transferring Costs to Cost of Goods Sold 1170

How Is the Manufacturing Overhead Account Adjusted? 1172

- Summary 1173

How Do Service Companies Use a Job Order Costing System? 1177

■ Review 1179

■ Assess Your Progress 1186

■ Critical Thinking 1210

CHAPTER 20

Process Costing 1216

How Do Costs Flow Through a Process Costing System? 1218

- Job Order Costing Versus Process Costing 1218
- Flow of Costs Through a Process Costing System 1219

What Are Equivalent Units of Production, and How Do You Calculate Them? 1221

- Equivalent Units of Production 1222
- Conversion Costs 1222

How Is a Production Cost Report Prepared? 1223

- Production Cost Report—First Process—Assembly Department 1224
- Production Cost Report—Second Process—Cutting Department 1230

What Journal Entries Are Required in a Process Costing System? 1239

How Can the Production Cost Report Be Used to Make Decisions? 1244

APPENDIX 20A: Process Costing: First-In, First-Out Method 1245

How Is a Production Cost Report Prepared Using the FIFO Method? 1245

- Comparison of Weighted-Average and FIFO Methods 1256

■ Review 1257

■ Assess Your Progress 1265

■ Critical Thinking 1286

CHAPTER 21

Cost-Volume-Profit Analysis 1292

How Do Costs Behave When There Is a Change in Volume? 1294

- Variable Costs 1294
- Fixed Costs 1295
- Mixed Costs 1297

What Is Contribution Margin, and How Is It Used to Compute Operating Income? 1302

- Contribution Margin 1302
- Unit Contribution Margin 1302
- Contribution Margin Ratio 1302
- Contribution Margin Income Statement 1302

How Is Cost-Volume-Profit (CVP) Analysis Used? 1304

- Assumptions 1304
- Target Profit—Three Approaches 1304
- Breakeven Point—A Variation of Target Profit 1307
- CVP Graph—A Graphic Portrayal 1307

How Is CVP Analysis Used for Sensitivity Analysis? 1309

- Changes in the Selling Price 1309
- Changes in Variable Costs 1310
- Changes in Fixed Costs 1310

What Are Some Other Ways CVP Analysis Can Be Used? 1311

- Margin of Safety 1311
- Operating Leverage 1312
- Sales Mix 1315

APPENDIX 21A: Variable Costing 1318

How Does Variable Costing Differ From Absorption Costing? 1318

- Absorption Costing 1318
- Variable Costing 1318
- Comparison of Unit Costs 1319

How Does Operating Income Differ Between Variable Costing and Absorption Costing? 1321

- Production Equals Sales 1321
- Production Exceeds Sales 1322
- Production Is Less Than Sales 1325
- Summary 1328

■ Review 1330

■ Assess Your Progress 1338

■ Critical Thinking 1361

CHAPTER 22

Master Budgets 1368

Why Do Managers Use Budgets? 1370

- Budgeting Objectives 1370
- Budgeting Benefits 1370
- Budgeting Procedures 1373
- Budgeting and Human Behavior 1373

Are There Different Types of Budgets? 1374

- Strategic and Operational Budgets 1374
- Static and Flexible Budgets 1374
- Master Budgets 1375

How Are Operating Budgets Prepared for a Manufacturing Company? 1377

- Sales Budget 1377
- Production Budget 1378
- Direct Materials Budget 1379
- Direct Labor Budget 1381
- Manufacturing Overhead Budget 1381
- Cost of Goods Sold Budget 1382
- Selling and Administrative Expense Budget 1383

How Are Financial Budgets Prepared for a Manufacturing Company? 1384

- Capital Expenditures Budget 1384
- Cash Budget 1385
- Budgeted Income Statement 1392
- Budgeted Balance Sheet 1393
- Budgeted Statement of Cash Flows 1394

How Can Information Technology Be Used in the Budgeting Process? 1396

- Sensitivity Analysis 1396
- Budgeting Software 1396

APPENDIX 22A: Budgeting for Merchandising Companies 1397

How Are Operating Budgets Prepared for a Merchandising Company? 1398

- Sales Budget 1398
- Inventory, Purchases, and Cost of Good Sold Budget 1400
- Selling and Administration Expense Budget 1401

How Are Financial Budgets Prepared for a Merchandising Company? 1402

- Capital Expenditures Budget 1402
- Cash Budget 1402
- Budgeted Income Statement 1406
- Budgeted Balance Sheet 1407
- Budgeted Statement of Cash Flows 1408

■ Review 1410

■ Assess Your Progress 1418

■ Critical Thinking 1448

CHAPTER 23

Flexible Budgets and Standard Cost Systems 1454

How Do Managers Use Budgets to Control Business Activities? 1457

- Performance Reports Using Static Budgets 1457
- Performance Reports Using Flexible Budgets 1458

Why Do Managers Use a Standard Cost System to Control Business Activities? 1463

- Setting Standards 1463
- Standard Cost System Benefits 1465
- Variance Analysis for Product Costs 1466

How Are Standard Costs Used to Determine Direct Materials and Direct Labor Variances? 1468

- Direct Materials Variances 1469
- Direct Labor Variances 1472

How Are Standard Costs Used to Determine Manufacturing Overhead Variances? 1474

- Allocating Overhead in a Standard Cost System 1474
- Variable Overhead Variances 1475
- Fixed Overhead Variances 1477

What Is the Relationship Among the Product Cost Variances and Who Is Responsible for Them? 1481

- Variance Relationships 1481
- Variance Responsibilities 1482

How Do Journal Entries Differ in a Standard Cost System? 1484

Journal Entries 1484

Standard Cost Income Statement 1488

■ Review 1491

■ Assess Your Progress 1500

■ Critical Thinking 1517

CHAPTER 24

Cost Allocation and Responsibility Accounting 1524

How Do Companies Assign and Allocate Costs? 1526

Single Plantwide Rate 1527

Multiple Department Rates 1529

Activity-Based Costing 1530

Traditional Costing Systems Compared to ABC Systems 1535

Why Do Decentralized Companies Need Responsibility Accounting? 1536

Advantages of Decentralization 1537

Disadvantages of Decentralization 1537

Responsibility Accounting 1538

What Is a Performance Evaluation System and How Is It Used? 1541

Goals of Performance Evaluation Systems 1541

Limitations of Financial Performance Measurement 1542

The Balanced Scorecard 1543

How Do Companies Use Responsibility Accounting to Evaluate Performance in Cost, Revenue, and Profit Centers? 1548

Controllable Versus Noncontrollable Costs 1548

Responsibility Reports 1548

How Does Performance Evaluation in Investment Centers Differ From Other Centers? 1553

Return on Investment (ROI) 1554

Residual Income (RI) 1557

Limitations of Financial Performance Measures 1559

APPENDIX 24A: Transfer Pricing 1561

How Do Transfer Prices Affect Decentralized Companies? 1561

Objectives in Setting Transfer Prices 1561

Setting Transfer Prices 1561

■ Review 1564

■ Assess Your Progress 1572

■ Critical Thinking 1592

CHAPTER 25

Short-Term Business Decisions 1596

How Is Relevant Information Used to Make Short-Term Decisions? 1598

Relevant Information 1598

Relevant Nonfinancial Information 1599

Differential Analysis 1599

How Does Pricing Affect Short-Term Decisions? 1601

Setting Regular Prices 1601

Special Pricing 1606

How Do Managers Decide Which Products to Produce and Sell? 1610

Dropping Unprofitable Products and Segments 1610

Product Mix 1613

Sales Mix 1617

How Do Managers Make Outsourcing and Processing Further Decisions? 1618

Outsourcing 1618

Sell or Process Further 1623

■ Review 1626

■ Assess Your Progress 1634

■ Critical Thinking 1652

CHAPTER 26

Capital Investment Decisions 1658

What Is Capital Budgeting? 1660

The Capital Budgeting Process 1660

Focus on Cash Flows 1663

How Do the Payback and Accounting Rate of Return Methods Work? 1664

Payback 1664

Accounting Rate of Return (ARR) 1667

What Is the Time Value of Money? 1671

Time Value of Money Concepts 1671

Present Value of a Lump Sum 1674

Present Value of an Annuity 1674

Summary 1675

How Do Discounted Cash Flow Methods Work? 1677

Net Present Value (NPV) 1678

Internal Rate of Return (IRR) 1683

Comparing Capital Investment Analysis Methods 1686

Sensitivity Analysis 1688

Capital Rationing 1691

■ Review 1694

■ Assess Your Progress 1701

■ Critical Thinking 1716

APPENDIX A—2011 Green Mountain Coffee Roasters, Inc. Annual Report 1721

APPENDIX B—Present Value Tables 1767

GLOSSARY 1771

INDEX 1781

PHOTO CREDITS 1797