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The Financial Chapters

ELEVENTH EDITION

Tracie Miller-Nobles • Brenda Mattison • Ella Mae Matsumura

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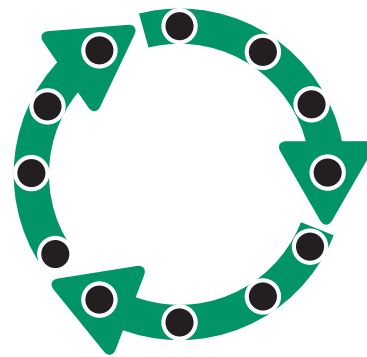
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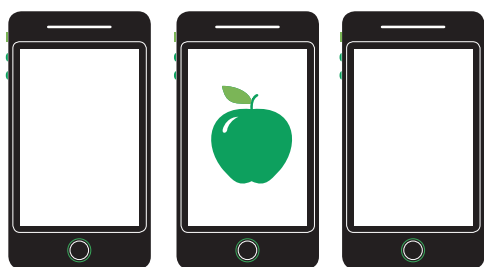
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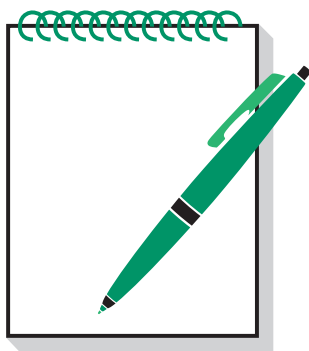
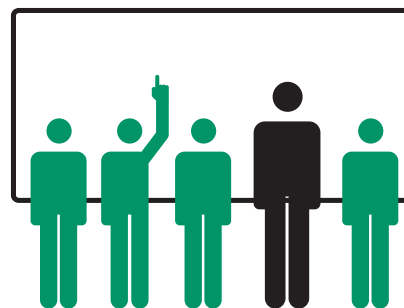
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THE FINANCIAL CHAPTERS

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Changes to This Edition

General

Revised end-of-chapter short exercises, exercises, problems, continuing problems, comprehensive problems, and critical thinking cases.
NEW! Added three comprehensive problems in managerial chapters.

Chapter 1

NEW! Added discussion of the Pathways Commission and incorporated the Pathways' Vision Model.
Clarified and simplified the financial statement presentation.

Chapter 3

NEW! Added discussion of the new revenue recognition principle.
Replaced the word *prepaids* with *deferrals* to better align with the presentation of the other types of adjusting entries.

Chapter 4

Increased the usage of the classified balance sheet as a requirement for end-of-chapter problems.

Chapter 10

Expanded the discussion on partial-year depreciation.

Chapter 11

Updated the payroll section for consistency with current payroll laws at the time of printing.

Chapter 13

Moved coverage of treasury stock before dividends to increase students' understanding of dividend transactions.
NEW! Added section on income tax expense and updated income statement presentation.

Horngren's Accounting...

Expanding on Proven Success

NEW!

Try It! Solution Videos—Author recorded solution videos accompany Try Its! Just click on the Try It! box and watch the author will walk students through the problem and the solution.

Startech Surveillance Services had the following adjustments as of the end of the year:

- Equipment depreciation was \$1,500. **D**
- \$700 of advertising expense was incurred but not paid. (Use Advertising Payable.) **A**
- Office Supplies on hand at the end of the year totaled \$250. The beginning balance of Office Supplies was \$600. **D**
- \$1,200 of rent revenue was earned but not recorded or received. **A**
- Unearned revenue of \$3,000 had been earned. **D**

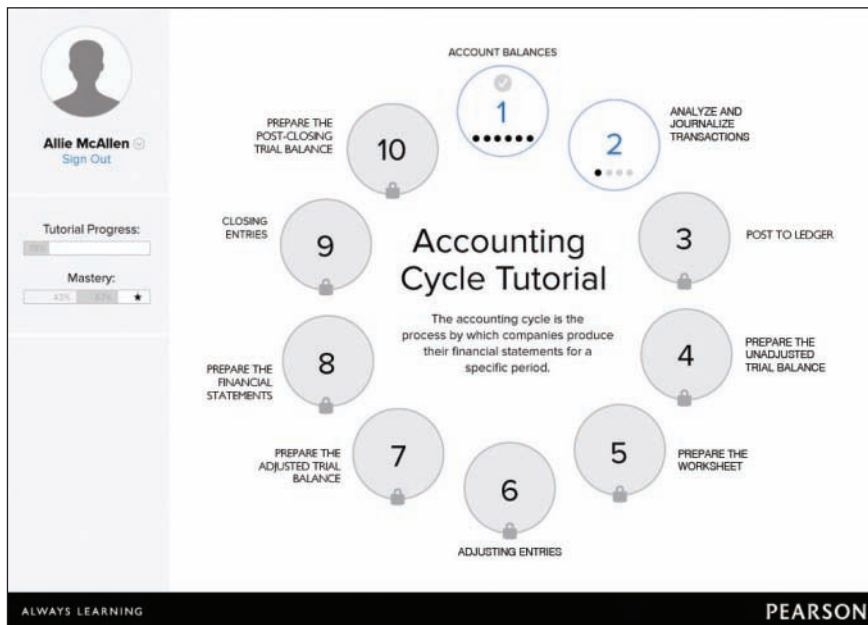
6. For each situation, indicate which category of adjustment (deferral or accrual) is described.
7. Journalize the adjusting entry needed.

Deferral: Cash occurs before revenue or expense
Accrual: Cash occurs after revenue or expense

| | | | |
|--------------|------|--------------|-----|
| a. Dep. Exp. | 1500 | b. Adv. Exp. | 700 |
| Acc. Dep. | 1500 | Adv. Pay. | 700 |

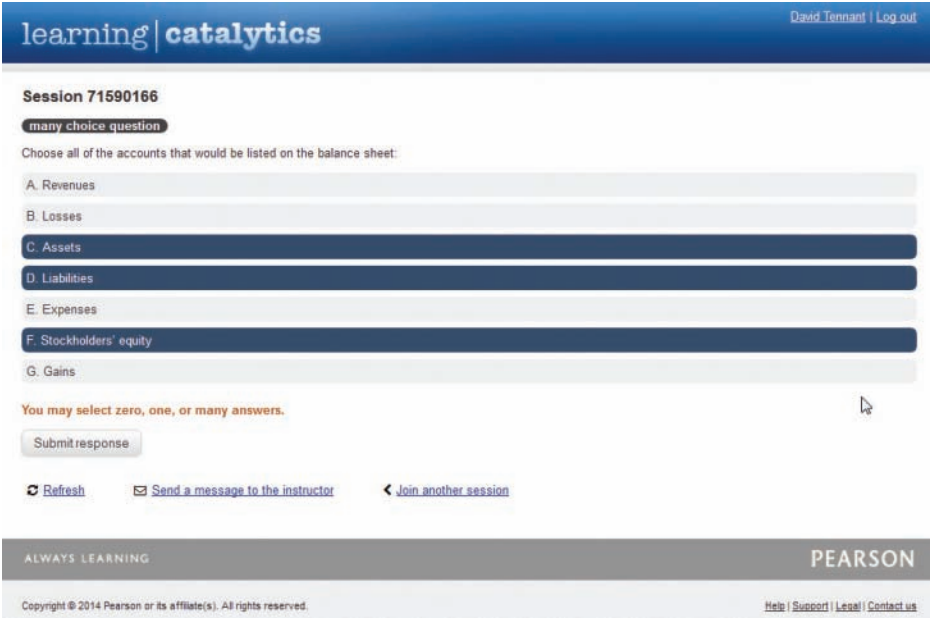
NEW!

Accounting Cycle Tutorial—MyAccountingLab's new interactive tutorial helps students master the Accounting Cycle for early and continued success in the introduction to Accounting course. The tutorial, accessed by computer, Smartphone, or tablet, provides students with brief explanations of each concept of the Accounting Cycle through engaging videos and/or animations. Students are immediately assessed on their understanding and their performance is recorded in the MyAccountingLab grade book. Whether the Accounting Cycle Tutorial is used as a remediation self-study tool or course assignment, students have yet another resource within MyAccountingLab to help them be successful with the accounting cycle.

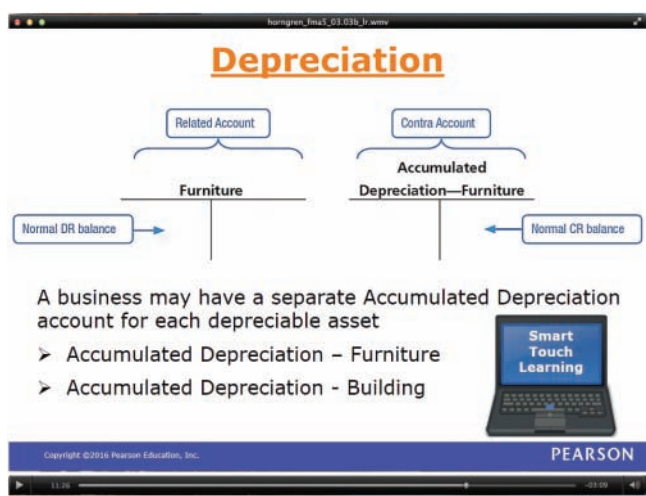




Learning Catalytics—A “bring your own device” assessment and classroom activity system that expands the possibilities for student engagement. Using Learning Catalytics, you can deliver a wide range of auto-gradable or open-ended questions that test content knowledge and build critical thinking skills. Eighteen different answer types provide great flexibility, including graphical, numerical, textual input, and more.



Animated Lectures—These pre-class learning aids are available for every learning objective and are professor-narrated PowerPoint summaries that will help students prepare for class. These can be used in an online or flipped classroom experience or simply to get students ready for lecture.



End-of-Chapter Continuing and Comprehensive Problems

> Continuing Problem

Problem P1-54 is the first problem in a sequence that begins an accounting cycle. The cycle is continued in Chapter 2 and completed in Chapter 5.

P1-54 Using the accounting equation for transaction analysis, preparing financial statements, and calculating return on assets (ROA)

Daniels Consulting began operations and completed the following transactions during December 2016:

| | |
|--------|--|
| Dec. 2 | Daniels contributed \$20,000 cash in exchange for capital. |
| 2 | Paid monthly office rent, \$2,000. |
| 3 | Paid cash for a computer, \$3,600. This equipment is expected to remain in service for five years. |
| 4 | Purchased office furniture on account, \$3,000. The furniture should last for five years. |
| 5 | Purchased office supplies on account, \$800. |
| 9 | Performed consulting service for a client on account, \$2,500. |
| 12 | Paid utilities expenses, \$150. |
| 18 | Performed service for a client and received cash of \$2,100. |
| 21 | Received \$2,400 in advance for client service to be performed in the future. (This increases the Unearned Revenue account, which is a liability. This account will be explained in more detail in Chapter 2.) |
| 21 | Hired an administrative assistant to be paid \$2,055 on the 20th day of each month. The secretary begins work immediately. |

Continuing Problem—Starts in Chapter 1 and runs through the entire book exposing students to recording entries for a service company and then moving into recording transactions for a merchandiser later in the text. The managerial chapters emphasize the relevant topics for that chapter using a continuous company.

Practice Set—Starts in Chapter 2 and goes through the financial chapters and provides another opportunity for students to practice the entire accounting cycle. The practice set uses the same company in each chapter but is often not as extensive as the continuing problem.

Comprehensive Problem 1 for Chapters 1–4—Covers the entire accounting cycle for a service company.

Comprehensive Problem 2 for Chapters 1–4—A continuation of Comprehensive Problem 1. It requires the student to record transactions for the month after the closing process.

Comprehensive Problem for Chapters 1–5—Covers the entire accounting cycle for a merchandise company.

Comprehensive Problem for Chapter 7—Uses special journals and subsidiary ledgers and covers the entire accounting cycle for a merchandise company. Students can complete this comprehensive problem using the MyAccountingLab General Ledger or Quickbooks™ software.

Comprehensive Problem for Chapter 17—Students use trend analysis and ratios to analyze a company for its investment potential.

> Comprehensive Problem 1 for Chapters 1–4

Magness Delivery Service completed the following transactions during December 2016:

| | |
|--------|--|
| Dec. 1 | Magness Delivery Service began operations by receiving \$10,000 cash and a truck with a fair value of \$20,000 from Robert Magness. The business gave Magness capital in exchange for this contribution. |
| 1 | Paid \$1,000 cash for a four-month insurance policy. The policy begins December 1. |
| 4 | Paid \$500 cash for office supplies. |
| 12 | Performed delivery services for a customer and received \$2,000 cash. |
| 15 | Completed a large delivery job, billed the customer, \$2,500, and received a promise to collect the \$2,500 within one week. |
| 18 | Paid employee salary, \$1,000. |
| 20 | Received \$15,000 cash for performing delivery services. |
| 22 | Collected \$800 in advance for delivery service to be performed later. |
| 25 | Collected \$2,500 cash from customer on account. |
| 27 | Purchased fuel for the truck, paying \$300 on account. (Credit Accounts Payable) |
| 28 | Performed delivery services on account, \$700. |
| 29 | Paid office rent, \$1,600, for the month of December. |
| 30 | Paid \$300 on account. |
| 31 | Magness withdrew cash of \$3,000. |

Requirements

1. Record each transaction in the journal using the following chart of accounts. Explanations are not required.

Chapter Openers

Chapter openers set up the concepts to be covered in the chapter using stories students can relate to. The implications of those concepts on a company's reporting and decision making processes are then discussed.

3

The Adjusting Process

Where's My Bonus?

Liam Mills was surprised when he opened his mail. He had just received his most recent quarterly bonus check from his employer, Custom Marketing, and the check was smaller than he expected. Liam worked as a sales manager and was responsible for product marketing and implementation in the southwest region of the United States. He was paid a monthly salary but also received a 3% bonus for all revenue generated from advertising services provided to customers in his geographical area. He was counting on his fourth quarter (October–December) bonus check to be large enough to pay off the credit card debt he had accumulated over the holiday break. It had been a great year-end for Liam. He had closed several open accounts, successfully signing several annual advertising contracts. In addition, because of his negotiating skills, he was able to collect half of the payments for services up front instead of waiting for his customers to pay every month. Liam expected that his bonus check would be huge because of this new business, but it wasn't.

The next day, Liam stopped by the accounting office to discuss his bonus check. He was surprised to learn that his bonus was calculated by the revenue earned by his company through December 31. Although Liam had negotiated to receive half of the payments up front, the business had not yet earned the revenue from those payments. Custom Marketing will not record revenue earned until the advertising services have been performed. Eventually Liam will see the new business reflected in his bonus check, but he'll have to wait until the revenue has been earned.

How Was Revenue Earned Calculated?
At the end of a time period (often December 31), companies are required to accurately report revenues earned and expenses incurred during that time period. In order to do this, the company reviews the account balances as of the end of the time period and determines whether any adjustments are needed. For example, CC Media Holdings, Inc., the parent company of radio giant Clear Channel Communications and Clear Channel Outdoor Holdings, an outdoor advertising agency, must determine the amount of revenue earned from open advertising contracts. These contracts can cover only a few weeks or as long as several years. Only the amount earned in the current time period is reported as revenue on the income statement. Adjusting the books is the process of reviewing and adjusting the account balances so that amounts on the financial statements are reported accurately. This is what we will learn in this chapter.

Effect on the Accounting Equation

Next to every journal entry, these illustrations help reinforce the connections between recording transactions and the effect those transactions have on the accounting equation.

On November 10, Smart Touch Learning performed services for clients, for which the clients will pay the company later. The business earned \$3,000 of service revenue on account.

This transaction increased Accounts Receivable, so we debit this asset. Service Revenue is increased with a credit.

$$\left. \begin{array}{l} \text{A}\uparrow \\ \text{Accounts} \\ \text{Receivable}\uparrow \end{array} \right\} = \left\{ \begin{array}{l} \text{L} + \text{E}\uparrow \\ \text{Service} \\ \text{Revenue}\uparrow \end{array} \right.$$

| Date | Accounts and Explanation | Debit | Credit |
|---------|---------------------------------------|-------|--------|
| Nov. 10 | Accounts Receivable | 3,000 | |
| | Service Revenue | | 3,000 |
| | <i>Performed services on account.</i> | | |

Instructor Tips & Tricks

Found throughout the text, these handwritten notes mimic the experience of having an experienced teacher walk a student through concepts on the “board.” Many include mnemonic devices or examples to help students remember the rules of accounting.

$$\left. \begin{array}{l} \text{A}\downarrow \\ \text{Accumulated} \\ \text{Depreciation} \\ \text{Building}\uparrow \end{array} \right\} = \left\{ \begin{array}{l} \text{L} + \text{E}\downarrow \\ \text{Depreciation} \\ \text{Expense—} \\ \text{Building}\uparrow \end{array} \right.$$

| Date | Accounts and Explanation | Debit | Credit |
|---------|--|-------|--------|
| Dec. 31 | Depreciation Expense—Building | 250 | |
| | Accumulated Depreciation—Building | | 250 |
| | <i>To record depreciation on building.</i> | | |

Remember, an increase in a contra asset, such as Accumulated Depreciation, decreases total assets. This is because a contra asset has a credit balance and credits decrease assets.

Common Questions, Answered

Our authors have spent years in the classroom answering students' questions and have found patterns in the concepts or rules that consistently confuse students. These commonly asked questions are located in the margin of the text next to where the answer or clarification can be found highlighted in orange text.



Why was the account Patent credited instead of Accumulated Amortization—Patent?

Notice that Smart Touch Learning credited the amortization directly to the intangible asset, Patent, instead of using an Accumulated Amortization account. A company may credit an intangible asset directly when recording amortization expense, or it may use the account Accumulated Amortization. **Companies frequently choose to credit the asset account directly because the residual value is generally zero and there is no physical asset to dispose of at the end of its useful life, so the asset essentially removes itself from the books through the process of amortization.**

At the end of the first year, Smart Touch Learning will report this patent at \$160,000 (\$200,000 cost minus first-year amortization of \$40,000), the next year at \$120,000, and so forth. Each year for five years the value of the patent will be reduced until the end of its five-year life, at which point its book value will be \$0.

Try It! Boxes

Found after each learning objective, these give students the opportunity to apply the concept they just learned to an accounting problem. Deep linking in the eText will allow students to practice in MyAccountingLab without interrupting their interaction with the eText.

Try It!

Total Pool Services earned \$130,000 of service revenue during 2016. Of the \$130,000 earned, the business received \$105,000 in cash. The remaining amount, \$25,000, was still owed by customers as of December 31. In addition, Total Pool Services incurred \$85,000 of expenses during the year. As of December 31, \$10,000 of the expenses still needed to be paid. In addition, Total Pool Services prepaid \$5,000 cash in December 2016 for expenses incurred during the next year.

1. Determine the amount of service revenue and expenses for 2016 using a cash basis accounting system.
2. Determine the amount of service revenue and expenses for 2016 using an accrual basis accounting system.

Check your answers online in MyAccountingLab or at <http://www.pearsonglobaleditions.com/Horngren>.

For more practice, see Short Exercises S3-1 and S3-2. [MyAccountingLab](#)

Redesigned

The redesign includes clean and consistent art for T-accounts, journal entries, financial statements, and the accounting equation. New art types include clear explanations and connection arrows to help students follow the transaction process.

$$\text{ASSETS} = \left\{ \begin{array}{l} \text{LIABILITIES} + \\ \text{Owner,} - \text{Owner,} + \text{Revenues} - \text{Expenses} \\ \text{Capital} \quad \text{Withdrawals} \end{array} \right. \text{EQUITY}$$

IFRS

Information on IFRS provides guidance on how IFRS differs from U.S. GAAP throughout the financial chapters.



Decision Boxes

This feature provides common questions and potential solutions business owners face. Students are asked to determine the course of action they would take based on concepts covered in the chapter and are then given potential solutions.

DECISIONS

Which depreciation method should be selected?

Three Junes Weaving has just purchased an automated weaving machine and is trying to figure out which depreciation method to use: straight-line, units-of-production, or double-declining-balance. Ira Glasier, the controller, is interested in using a depreciation method that approximates the usage of the weaving machine. He also expects that the weaving machine will have increasing repairs and maintenance as the asset ages. Which method should Ira choose?

Solution

If Ira is interested in using a depreciation method that approximates the usage of the weaving machine, he should use the units-of-production method to depreciate the asset. He could use number of machine hours as the unit of output. This method

would best match the usage of the machine to the amount of expense recorded. Ira should be aware, though, that this method could produce varying amounts of depreciation expense each year. For example, if Three Junes Weaving does not use the weaving machine in one year, no depreciation expense would be recorded. This could cause net income to vary significantly from year to year. Because Ira expects the weaving machine to need more repairs as the asset ages, Ira might consider using the double-declining-balance method instead. The double-declining-balance method records a higher amount of depreciation in the early years and less later. This method works well for assets that are expected to have increasing repairs and maintenance in their later years because the total expense (depreciation and repairs and maintenance) can be spread out equally over the life of the asset.

> Things You Should Know

1. How do we prepare financial statements?

- Financial statements are prepared from the adjusted trial balance in the following order:
 1. Income statement—reports revenues and expenses and calculates net income or net loss during the period
 2. Statement of owner's equity—shows how capital changed during the period due to owner contributions, net income or net loss, and owner withdrawals
 3. Balance sheet—reports assets, liabilities, and owner's equity as of the last day of the period
- A classified balance sheet classifies each asset and each liability into specific categories.

2. How could a worksheet help in preparing financial statements?

- The columns of a worksheet can be extended to help in preparing the financial statements.
- The income statement section will include only revenue and expense accounts.
- The balance sheet section will include asset and liability accounts and all equity accounts except revenues and expenses.

Things You Should Know

Provides students with a brief review of each learning objective presented in a question and answer format.

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Dear Colleague,

Thank you for taking time, out of what we know is a busy schedule, to review the newest edition of *Horngren's Accounting*. We are excited to share our innovations with you as we expand on the proven success of our significant revision to the Horngren franchise. Using what we have learned from focus groups, market feedback, and our colleagues, we've designed this edition to focus on several goals.

First, we made certain that our content was clear, consistent, and above all, accurate. As authors, we reviewed each chapter to ensure that students understand what they are reading and that there is consistency from chapter to chapter. In addition, our textbook goes through a multi-level accuracy check which includes the author team working every single accounting problem and having a team of accounting professors from across the nation review for accuracy. Next, through ongoing conversations with our colleagues and our time engaged at professional conferences, we confirmed that our pedagogy and content represents the leading methods used in the classroom and provides your students with the foundation they need to be successful in their future academic and professional careers. Lastly, we concentrated on student success and providing resources for professors to create an active and engaging classroom.

Student success. Using our experience as educators, our team carefully considered how students learn, what they learn, and where they struggle the most. We understand that sometimes there is a gap in students' understanding between the textbook content and what is done in the classroom or in an online environment, so we have included in the textbook and eText several great learning aids for students. *Instructor Tips and Tricks* and *Common Questions Answered* address areas that are typically challenging for students. These aids provide handy memory tools or address common student misconceptions or confusion. We also realized that students use our eText to study on their own time and we have built in many new features to bring learning to life and to allow students to apply the concepts they are reading about outside of the classroom. Available through MyAccountingLab, students have the opportunity to watch author recorded solution videos, practice the accounting cycle using an interactive tutorial, and watch in-depth author-driven animated lectures that cover every learning objective.

Professor expectations. As professors, we know it's critical to have excellent end-of-chapter material and instructor resources. With these expectations, all end-of-chapter problems have been revised and our author team, along with our trusted accuracy checkers, have checked every problem for accuracy and consistency. In addition to financial comprehensive problems, three NEW comprehensive problems have been added to the managerial content. These problems cover multiple chapters and encourage students to think reflectively about prior material learned and the connections between accounting concepts. We have also reviewed and updated ALL instructor resources to accompany this edition of the book. In addition, the PowerPoint presentations and Test Bank have had significant revisions based upon your feedback and needs.

Expanding on the proven success of our last edition, we believe that our enhancements to *Horngren's Accounting*, along with MyAccountingLab, will help your students achieve success in accounting. We welcome your feedback, suggestions, and comments. Please don't hesitate to contact us at HorngrensAccounting@pearson.com.

Tracie L. Miller-Nobles, CPA Brenda Mattison Ella Mae Matsumura, PhD

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