

SOLUTIONS MANUAL

Stice | Stice

Intermediate^{18e}
Accounting



CHAPTER 2

A Review of the Accounting Cycle

► LEARNING OBJECTIVES

1. Identify and explain the basic steps in the accounting process (accounting cycle).
 - Analyze business documents,
 - Journalize transactions,
 - Post to ledger accounts,
 - Prepare a trial balance,
 - Prepare adjusting entries,
 - Prepare financial statements,
 - Close the nominal accounts, and
 - Prepare a post-closing trial balance.
2. Analyze transactions and make and post journal entries.
 - Transactions are events that transfer or exchange goods or services between two or more entities.
 - The data are recorded with journal entries using a system of double-entry accounting.
 - The entries are subsequently posted to ledger accounts.
3. Make adjusting entries, produce financial statements, and close nominal accounts.
 - Adjusting entries are made at the end of an accounting period prior to preparing financial statements for that period.
 - At the end of each accounting cycle, the nominal or temporary accounts must be transferred through the closing process to real or permanent accounts.
4. Distinguish between accrual and cash-basis accounting.
5. Discuss the importance and expanding role of computers to the accounting process.
 - In the past, many companies used manual systems to record, classify, summarize, and report accounting data.
 - Today, most companies use computers and electronic technology as an integral part of their accounting systems.
 - In the future, technological advances will continue to significantly impact the accounting process of recording and reporting data for decision-making purposes.

► CHAPTER REVIEW OUTLINE

- I. OVERVIEW OF THE ACCOUNTING PROCESS (p. 2-53).
 - A. Recording phase.
 1. Collecting information about economic events.
 2. Double-entry accounting procedures.
 - B. Reporting phase: organizing and summarizing recorded information.
 - C. The recording and reporting phases may overlap.
- II. RECORDING PHASE (p. 2-55).
 - A. Transactions: transfer or exchange of goods or services between or among two or more entities
 - B. Double entry accounting
 1. Basic accounting equation: $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$
 2. Debits are entries on left side of accounts and credits are entries to right side of accounts.
 3. Journal entries provide a systematic method for summarizing a business event's effect on the basic accounting equation.
 4. Summary
 - a. Assets are increased by debits and decreased by credits.
 - b. Liability and owners' equity accounts are increased by credits and decreased by debits.
 - c. Owners' equity for a corporation includes capital stock and retained earnings accounts.
 - d. Revenues, expenses, and dividends relate to owners' equity through the retained earnings account.
 - e. Expenses and dividends are increased by debits and decreased by credits.
 - f. Revenues are increased by credits and decreased by debits.
 - g. $\text{Revenues} - \text{expenses} = \text{net income for the period}$, which increases owners' equity through retained earnings.
 - C. Analyzing business documents
 - D. Journalizing Transactions
 1. Special journal: records frequently recurring transactions
 2. General journal: records all transactions not recorded in special journals.
 - E. Posting to the ledger accounts
 1. An account is used to summarize the effects of transactions on each element of the expanded accounting equation.

- 2 Posting is the process of transferring information from journal entries to ledger accounts.
2. The general ledger is a collection of all control accounts - those appearing in financial statements.
3. A subsidiary ledger is a collection of accounts that contain supporting detail for the balances of control accounts in the general ledger.

III. REPORTING PHASE (p. 2-60).

- A. A trial balance is a listing of all accounts and their balances and indicates whether total debits = total credits, thus providing a *general* check on the accuracy of the recording and posting process applied throughout the fiscal period.
- B. Preparing adjusting entries
 1. *Unrecorded receivables*—revenues earned, but not recorded at the end of an accounting period which require an adjusting entry.
 2. *Unrecorded liabilities*—obligations that exist at the end of an accounting period which have not been recorded and require an adjusting entry.
 3. *Prepaid expenses*—recorded cash payments for benefits not yet received or only partially so.
 - a. *Was recorded by an original debit to an asset account*—now, debit expense and credit asset.
 - b. *Was recorded by an original debit to expense*—now, debit asset and credit expense.
 4. *Unearned revenues*—recorded cash receipts for services to be rendered in the future or only partially rendered at the balance sheet date.
 - a. *Was recorded by an original credit to a revenue account*—now, debit revenue and credit liability.
 - b. *Was recorded by an original credit to a liability account*—now, debit liability and credit revenue.
 5. *Asset depreciation*—a systematic allocation of an asset's cost to expense and a reduction, using a contra (or offset) account, in carrying value for a period during which the asset is used in operations.
 - b. *Bad Debts*—estimated amount of uncollectible accounts receivable charged to current period's income as bad debt expense.
- C. Preparing financial statements.
- D. Using a spreadsheet.
- E. Closing the nominal accounts—balances in the nominal (temporary) accounts are transferred to real (permanent) accounts using closing entries.
- F. A post-closing trial balance is a listing of all *real* accounts and their balances and indicates whether total debits = total credits, thus providing a *general* check on the accuracy of recording and posting closing entries.

IV. ACCRUAL VERSUS CASH-BASIS ACCOUNTING (p. 2-72).

A. Accrual accounting

1. Recognizes revenues as they are earned, not necessarily when cash is received.
2. Recognizes and records expenses when they are incurred, not necessarily when cash is paid.
3. Provides a better matching of revenues and expenses during an accounting period and results in more accurate financial statements.

B. Cash-basis accounting

1. Based on cash receipts and cash disbursements.
2. Frequently found in organizations not requiring a complete set of double-entry records.
3. As of 2009, the IASB introduced another alternative to full GAAP: *IFRS for SMEs* (small and medium-sized entities).

VII. COMPUTERS AND THE ACCOUNTING PROCESS (p. 2-74).

- A. As organizations grow in size and complexity, recording and summarizing processes become more involved.
- B. Computers cannot replace skilled accountants. The presence of computers places increased demands on the accountant in directing the operations of the computer systems to assure the use of appropriate procedures.
- C. Recently XRBL (eXtensible Business Reporting Language) has been developed and will greatly simplify the process of analyzing financial statement data. This computer language allows a company's financial statement data to be downloaded into a spreadsheet for easy comparative analysis of company financial data.

VIII. REVIEW CHAPTER 2 (pp. 2-76 – 2-77).

IX. KEY TERMS (p. 2-77).

► Teaching Suggestions and Strategies

Adjusting Entries

Encourage students to analyze potential adjusting entries by using a logical approach such as the following. First, determine which accounts are affected and their desired ending balances.

Second, determine how the related original transaction was recorded. Third, determine the change in the balances that is needed to adjust from the original balances to the desired balances. Repeated application of this strategy is a useful study strategy for students.

► DESCRIPTION OF CHAPTER FEATURES

| | |
|-------------------------------|--|
| Opening Scenario, p. 2-1 | <i>The Hunt for Red October</i> |
| Exhibit 2-1, p. 2-4 | The Accounting Process |
| Stop and Think, p. 2-5 | Bookkeeper vs. Accountant |
| Exhibit 2-2, p. 2-6 | Debit and Credit Relationships of Accounts |
| Exhibit 2-3, p. 2-8 | Double-Entry Accounting: Illustrative Transactions and Journal Entries |
| Illustration, p. 2-9 | General Journal |
| Illustration, p. 2-9 | General Ledger |
| Stop and Think, p. 2-10 | Posting Process Errors |
| Illustration, p. 2-11 | Trial Balance |
| Illustration, p. 2-13 | Adjusting Data |
| Illustration, p. 2-20 | Work Sheet |
| Illustration, p. 2-21 | Closing Entries |
| Illustration, p. 2-22 | Post-Closing Trial Balance |
| FASB Codification, p. 2-24 | Personal Balance Sheet |

► TOPICAL OVERVIEW OF END-OF-CHAPTER ASSIGNMENTS

| Topics | Quest. | Practice | | Probs. | Discuss. Cases |
|---|--------|----------|----------------------------|-----------------|----------------|
| | | Ex. | Ex. | | |
| 1. General overview of the accounting process | 1-4 | | | | |
| 2. The recording phase | 5-6 | 1-7 | 19; 25; 31 | 33-34 | 43 44 |
| 3. The reporting phase | 7-15 | 8-18 | 20-24; 26-30; 31; 32 | 35-38; 39-42 | |
| 4. Accrual vs. cash accounting | 16-17 | | | 38 | 46-48 |
| 5. Computers and the accounting process | 18-19 | | | | 45 |

► ASSIGNMENT CATALOG

| Practice Exercise | Description | Difficulty Level | Time Range (Minutes) |
|-------------------|---------------|------------------|----------------------|
| 2-1 | Journalizing | E | 5-15 |
| 2-2 | Journalizing | E | 5-15 |
| 2-3 | Journalizing | E | 5-15 |
| 2-4 | Journalizing | E | 5-15 |
| 2-5 | Journalizing | E | 5-15 |
| 2-6 | Posting | E | 5-15 |
| 2-7 | Posting | E | 5-15 |
| 2-8 | Trial balance | E | 5-15 |

| | | | |
|------|-------------------|---|------|
| 2-9 | Trial balance | E | 5-15 |
| 2-10 | Income statement | E | 5-15 |
| 2-11 | Balance sheet | E | 5-15 |
| 2-12 | Adjusting entries | E | 5-15 |
| 2-13 | Adjusting entries | E | 5-15 |
| 2-14 | Adjusting entries | E | 5-15 |
| 2-15 | Adjusting entries | E | 5-15 |
| 2-16 | Adjusting entries | E | 5-15 |
| 2-17 | Closing entries | E | 5-15 |
| 2-18 | Closing entries | E | 5-15 |

| Exercise | Description | Difficulty Level | Time Range (Minutes) |
|-----------------|--|-------------------------|-----------------------------|
| 2-19 | Recording transactions in T-Accounts | M | 20-25 |
| 2-20 | Adjusting entries | E | 20-25 |
| 2-21 | Adjusting/correcting entries | M | 20-25 |
| 2-22 | Reconstructing adjusting entries | M | 15-20 |
| 2-23 | Adjusting and closing and post-closing trial balance | E | 15-20 |
| 2-24 | Adjusting and closing entries and post-closing trial balance | M | 40-50 |
| 2-25 | Analysis of journal entries | M | 25-30 |
| 2-26 | Adjusting entries | M | 15-20 |
| 2-27 | Adjusting entries | M | 20-25 |
| 2-28 | Analyzing adjusting entries | M | 15-20 |
| 2-29 | Closing entries | M | 10-15 |
| 2-30 | Closing entries | M | 10-15 |
| 2-31 | Determining income from equity account analysis | M | 10-15 |
| 2-32 | Accrual errors | M | 15-20 |

| Problem | Description | Difficulty Level | Time Range (Minutes) |
|----------------|--|-------------------------|-----------------------------|
| 2-33 | Journal entries | M | 40-50 |
| 2-34 | Account classification & debit/credit relationship | E | 15-20 |
| 2-35 | Adjusting entries | E | 20-30 |
| 2-36 | Analysis of adjusting entries | M | 15-25 |
| 2-37 | Adjusting entries | M | 20-30 |
| 2-38 | Cash to accrual adjusting entries and income statement | M | 20-30 |
| 2-39 | Adjusting and closing entries | M | 45-60 |
| 2-40 | Adjusting and closing entries and post-closing trial balance | M | 45-60 |
| 2-41 | Preparation of work sheet | M | 45-60 |
| 2-42 | Preparation of work sheet and adjusting/closing entries | D | 45-60 |

| Discussion | | Difficulty Level | Time Range (Minutes) |
|-------------------|---|-------------------------|-----------------------------|
| Case | Description | | |
| 2-43 | Where is your cash box? | E | 10-15 |
| 2-44 | To record or not to record. | M | 20-25 |
| 2-45 | Is it time to revolutionize the recording of business events? | M | 20-25 |
| 2-46 | When cash basis is different from accrual basis. | E | 15-20 |
| 2-47 | The impact of computers on financial reporting. | M | 20-25 |
| 2-48 | But I need more timely information! | M | 20-25 |

Other Cases

| | |
|------|---|
| 2-49 | Deciphering Financial Statements (The Walt Disney Company) |
| 2-50 | Writing Assignment (I am going to be an accountant—not a bookkeeper!) |
| 2-51 | Ethical Dilemma (The art of making adjusting entries) |
| 2-52 | Cumulative Spreadsheet Analysis |