HORNGREN’S
Financial & Managerial Accounting
THE FINANCIAL CHAPTERS
SEVENTH EDITION

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Austin Community College

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About the Authors

Tracie L. Miller-Nobles, CPA, is an associate professor at Austin Community College. She has teaching experience at the community college and university level. Prof. Miller-Nobles received her master’s degree in accounting from Texas A&M University and is working on her doctoral degree in Adult Education also from Texas A&M University. Her research interest includes financial literacy education, adult learning theories, and online learning. She has public accounting experience with Deloitte Tax LLP.

Prof. Miller-Nobles is on the Board of Directors for the American Accounting Association (AAA) as Director-Focusing on Members. She has served in leadership roles for AAA’s Teaching, Learning, and Curriculum section and AAA’s Two Year College section and was a member of the Pathway’s Commission on Accounting Higher Education. Prof. Miller-Nobles is also on the Board of Directors for Teachers of Accounting at Two-Year Colleges (TACTYC) as Secretary/Webmaster. She is an active member of the American Institute of Certified Public Accountants (AICPA) Consumer Financial Education Advocates committee. At the state level, she serves on the Relations with Educational Institutes for the Texas Society of Certified Public Accountants (TXCPA).

Tracie has received several teaching and professional awards including the AAA J. Michael and Mary Anne Cook Prize, TXCPA Outstanding Accounting Educator, TXCPA Rising Star, and the TXCPA Austin Chapter CPA of the Year. In her spare time, Tracie enjoys spending time with her husband, Kevin, his three kids, Caleb, Josh, and Meggie, her parents, Kipp and Sylvia, and sister, Michelle. She believes that camping and hiking is restorative and calming and that life was meant for good friends and great adventures. Tracie has been mentored by many wonderful colleagues and inspired by her students.

Brenda L. Mattison, CMA, has a bachelor’s degree in education and a master’s degree in accounting, both from Clemson University. She is currently an Accounting Instructor at Tri-County Technical College in Pendleton, South Carolina. Brenda previously served as Accounting Program Coordinator at TCTC and has prior experience teaching accounting at Robeson Community College, Lumberton, North Carolina; University of South Carolina Upstate, Spartanburg, South Carolina; and Rasmussen Business College, Eagan, Minnesota. She also has accounting work experience in retail and manufacturing businesses and is a Certified Management Accountant.

Brenda is a member of the American Accounting Association, Institute of Management Accountants, South Carolina Technical Education Association, and Teachers of Accounting at Two Year Colleges. She is currently serving on the Board of Directors as Vice President of Conference Administration of Teachers of Accounting at Two Year Colleges.

Brenda previously served as Faculty Fellow at Tri-County Technical College. She has presented at state, regional, and national conferences on topics including active learning, course development, and student engagement.

In her spare time, Brenda enjoys reading and spending time with her family. She is also an active volunteer in the community, serving her church and other organizations.
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Preflighted

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Financial & Managerial Accounting . . .
Expanding on Proven Success

What’s New to the Edition

UPDATED! End of Chapter exercises and problems have been updated with new years and company financial information.

UPDATED! Chapter openers, Tying It All Together features, and financial statement analysis companies (Kohl's and Target) have been updated with current company financial information.

NEW FEATURE ON DATA ANALYTICS! Data Analytics is becoming critically important in business—specifically in accounting.

A new feature called Data Analytics in Accounting has been integrated throughout the narrative. In an increasingly competitive environment, having the ability to harness information to make sound business decisions is becoming crucial. Throughout the chapters, this feature highlights how real companies use Data Analytics to track inventory, monitor cash flow, forecast sales, and maximize profits. This feature also discusses emerging technologies, such as robotic process automation and artificial intelligence, and how they relate to businesses.

NEW DATA ANALYTICS PROJECTS! Each project contains a list of requirements, a dataset, a tutorial video, and instructions for using software such as Excel, Power BI, or Tableau to offer students hands-on practice in analyzing and reporting data. Using these tools, students learn how to extract and examine key information about a company related to its products, operations, and consumer buying habits. With this experience and knowledge, students are able to make smarter business decisions and are better prepared for the workforce.

NEW COVERAGE ON EMPLOYABILITY! The first courses in accounting are a great place to discuss the importance of accounting credentials in today’s job market. Throughout the narrative, we highlight the role of accounting in businesses including the most relevant accounting credentials, as well as some new ones for students beginning their study of accounting. When discussing accounting in the business environment, in addition to the traditional career path (CPA), we also provide information about additional certifications available to accounting majors including Certified Management Accounting (CMA), Chartered Global Management Accountant (CGMA), and Certified Financial Planner (CFP).

Chapter 1: Accounting and the Business Environment

• Added discussion on additional certifications available to accounting majors including Chartered Global Management Accountant and Certified Financial Planner.
• Added discussion on the need for technology skills and knowledge for accountants.
• Clarified the equity discussion to help students better understand the changes in equity based on customer feedback/requests.

Chapter 2: Recording Business Transactions

• Added Data Analytics in Accounting feature about the chart of accounts.

Chapter 5: Merchandising Operations

• Realigned the order of the purchase section to better explain how a company records purchase returns and corresponding payment.
• Realigned the order of sales section to better explain how a company records sales returns and corresponding receipt.
• Added T-accounts to help students understand the journal entries.
• Added customer and vendor names for Accounts Receivable and Accounts Payable.
• Moved adjusting sales revenue and merchandise inventory for estimated sales returns to LO4 which covers adjusting and closing entries for merchandisers.
• Realigned Appendix 5B purchases and sales sections to better explain how a company records these transactions.
• Clarified discussion of how a periodic inventory system records estimated sales returns.
• Modified Check Your Understanding F5-2 to include the new accounts introduced under Revenue Recognition Standard.
• Reviewed EOC to ensure that all new accounts (Estimated Returns Inventory, Refunds Payable, and Sales Discounts Forfeited) were adequately covered in problems.
• Adjusted EOC to give options for professors who do not want to cover Sales Returns and Allowances (Estimated Returns Inventory and Refunds Payable).
• Optional online appendix (and associated End of Chapter exercises) available for faculty who would like to cover the gross method of recording accounting receivables.

Chapter 6: Merchandising Inventory
• Added Data Analytics in Accounting feature discussing how companies track inventory.
• Added more explanation for how to calculate inventory cost flow for FIFO, LIFO, and weighted average under perpetual method.

Chapter 7: Internal Control and Cash
• Added Data Analytics in Accounting feature on cryptocurrencies and blockchain.
• Added internal control procedures for accepting debit and credit card sales.
• Changed company used in Tying It All Together feature to Chipotle Mexican Grill and discussed the unauthorized malware activity that occurred in April 2017.

Chapter 8: Receivables
• Changed company used in Tying It All Together feature from Sears to Amazon.com, Inc.

Chapter 9: Plant Assets, Natural Resources, and Intangibles
• Added Data Analytics in Accounting feature on water and energy consumption.

Chapter 11: Current Liabilities and Payroll
• Updated payroll tax amounts for 2019 (current at time of printing).

Chapter 14: The Statement of Cash Flows
• Added Data Analytics in Accounting feature on monitoring cash flow.
Solving Learning and Teaching Challenges

Accounting Cycle Tutorial
This 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, interactive activities. Students are immediately assessed on their understanding and their performance is recorded. A built-in comprehensive problem can be assigned to reinforce the lessons learned in the accounting cycle tutorial. Whether the Accounting Cycle Tutorial is used as a remediation self-study tool or course assignment, students have yet another resource to help them be successful with the accounting cycle.

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.

Tying It All Together
This feature ties together key concepts from the chapter using the company highlighted in the chapter opener. The in-chapter box feature presents scenarios and questions that the company could face and focuses on the decision-making process. The End of Chapter business case helps students synthesize the concepts of the chapter and reinforce critical thinking.

Try It!
Benson Auto Repair had the following account balances after adjustments. Assume all accounts had normal balances.

<table>
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<tr>
<td>Cash: $4,000</td>
</tr>
<tr>
<td>Notes Payable: $7,000</td>
</tr>
<tr>
<td>Equipment: $34,800</td>
</tr>
<tr>
<td>Accounts Receivable: $3,200</td>
</tr>
<tr>
<td>Prepaid Rent: $1,900</td>
</tr>
<tr>
<td>Equipment: $30,000</td>
</tr>
<tr>
<td>Dividends: $2,100</td>
</tr>
<tr>
<td>Common Stock: $20,000</td>
</tr>
<tr>
<td>Income Tax Expense: $182</td>
</tr>
<tr>
<td>Other Income: $695</td>
</tr>
<tr>
<td>Depreciation Expense: $300</td>
</tr>
<tr>
<td>Retained Earnings, January 1: $15,700</td>
</tr>
</tbody>
</table>

What is the balance of Retained Earnings after closing entries have been recorded? (Use a T-account to determine the balance.)

Prepare the closing entries for Benson at December 31.

For more practice, see Short Exercises S-F:4-9 through S-F:4-12.

Completing the Accounting Cycle Financial 4-15

Accounts Payable; and equity, such as Common Stock and Retained Earnings, are examples of permanent accounts that Hyatt Hotels might have included in their balances at the end of the period. Revenues, expenses, and dividends are all temporary accounts.

Temporary accounts are important in the closing process because their balances relate to a particular accounting period and are closed at the end of the period. Revenues, expenses, and dividends are all temporary accounts. Some examples of temporary accounts that Hyatt Hotels might have include Owned and Leased Hotels Revenue; Selling, General, and Administrative Expense; Interest Expense; and Dividends.

Would Hyatt Hotels Corporation record closing entries and why?

Hyatt Hotels would record closing entries in order to get the accounts ready for next year. All companies record closing entries in order to zero out all revenue and expense accounts. In addition, the closing process updates the retained earnings account balance for net income or loss during the period and any dividends paid to stockholders.

Why are temporary accounts important in the closing process? Why are temporary accounts important in the closing process because their balances relate to a particular accounting period and are closed at the end of the period. Revenues, expenses, and dividends are all temporary accounts. Some examples of temporary accounts that Hyatt Hotels might have included in their balances at the end of the period are Owned and Leased Hotels Revenue; Selling, General, and Administrative Expense; Interest Expense; and Dividends.

What type of temporary accounts would Hyatt Hotels Corporation have?

Temporary accounts are important in the closing process because their balances relate to a particular accounting period and are closed at the end of the period. Revenues, expenses, and dividends are all temporary accounts. Some examples of temporary accounts that Hyatt Hotels might have included in their balances at the end of the period are Owned and Leased Hotels Revenue; Selling, General, and Administrative Expense; Interest Expense; and Dividends.

How would Hyatt Hotels Corporation prepare its post-closing trial balance? What type of accounts would be reported on this trial balance?

A post-closing trial balance is a list of all permanent accounts and their balances at the end of the accounting period and is prepared after the closing process. Hyatt Hotels Corporation would report only permanent accounts on its post-closing trial balance. Some examples of permanent accounts that Hyatt Hotels might have included are assets, such as Cash and Property, Plant, and Equipment; liabilities, such as Accounts Payable; and equity, such as Common Stock and Retained Earnings.


<table>
<thead>
<tr>
<th>Account Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue: $4,154</td>
</tr>
<tr>
<td>Selling, general, and administrative expense: $6,122</td>
</tr>
<tr>
<td>Other expense: $495</td>
</tr>
<tr>
<td>Interest expense: $76</td>
</tr>
<tr>
<td>Income tax expense: $182</td>
</tr>
<tr>
<td>Dividends: $60</td>
</tr>
<tr>
<td>Retained earnings, December 31: $3,118</td>
</tr>
</tbody>
</table>

Requirements

3. Review the Hyatt Hotels Corporation’s balance sheet included in the 2018 annual report and find the Retained Earnings, December 31, 2018. Does your ending Retained Earnings calculation in Requirement 2 match?
Effect on the Accounting Equation
Next to every journal entry in both financial and managerial chapters, these illustrations help reinforce the connections between recording transactions and the effect those transactions have on the accounting equation.

On November 8, Smart Touch Learning collected cash of $5,500 for service revenue that the business earned by providing e-learning services for clients.

The asset Cash increased, so we debit Cash. Revenue increased, so we credit Service Revenue.

![Accounting Equation Diagram]

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.

![Instructor Tips & Tricks Diagram]

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 purple text.

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.

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

What e-commerce internal controls should be put into place?

Jason Kane works as an information technology auditor for Netproducts, a retailer that sells merchandise over the Internet. Jason has been assigned the responsibility of reviewing the existing procedures and suggesting internal controls that could best protect the company. Netproducts sells all its merchandise over the Internet and accepts only credit card payments. Netproducts tracks trend information about its sales and maintains all customer, product, and pricing information on the company’s intranet. In addition, Netproducts keeps employee information such as annual leave, payroll deposits, and Social Security numbers on its intranet. What e-commerce controls should Jason suggest?

Solution
Jason should suggest that specific controls be put into place, such as using encryption technology and firewalls, to protect customer and employee information. He should recommend that customers be required to create an online account with a password for the site and that the company only use secured Internet networks. In addition, Netproducts should ensure that the customer and employee data are physically secured and that access to the data can be obtained only by authorized individuals.

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

> 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 retained earnings—shows how retained earnings changed during the period due to net income or net loss and dividends
     3. Balance sheet—reports assets, liabilities, and stockholders’ 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.

Using Excel Problems
This End-of-Chapter problem introduces students to Excel to solve common accounting problems as they would in the business environment. Students will work from a template that will aid them in solving the problem related to accounting concepts taught in the chapter. Each chapter focuses on different Excel skills.

End-of-Chapter Continuing and Comprehensive Problems

Continuing Problem—Starts in Chapter F:1 and runs through the financial chapters, exposing students to recording entries for a service company and then moving into recording transactions for a merchandiser later in the text.
Practice Set—Starts in Chapter F: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 F:1–F:4—Covers the entire accounting cycle for a service company.

Comprehensive Problem 2 for Chapters F:1–F: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 F:5 and F:6—Covers the entire accounting cycle for a merchandising company, including analysis.

Comprehensive Problem for Chapters F:7, F:8, and F:9—Covers cash, receivables, and long-term assets transactions and analysis.

Comprehensive Problem for Chapters F:11, F:12, and F:13—Covers payroll, other current liabilities, long-term liabilities, and stockholders’ equity transactions and analysis.

Comprehensive Problem for Appendix B—Uses special journals and subsidiary ledgers and covers the entire accounting cycle for a merchandising company. Students can complete this comprehensive problem using the MyAccountingLab General Ledger or Quickbooks® software.
Dear Colleague,

Thank you for taking the time to review Horngren’s Financial and Managerial Accounting. We are excited to share our most recent changes and innovations with you as we expand on the proven success of the Horngren franchise. Using what we learned from market feedback, our colleagues, and our students, we’ve designed this edition to focus on several goals.

This edition we again focus on ensuring that we produce a textbook that provides students with the content and resources they need to be successful. We continually update our pedagogy and content to represent the leading methods and topics necessary for student success. As authors, we reviewed each and every component to ensure the textbook, student resources, and instructor supplements are clear, consistent, and accurate. We value our ongoing conversations with our colleagues and our time engaged at professional conferences to confirm that our textbook is up-to-date and we are providing resources for professors to create an active and engaging classroom.

We are excited to share with you some new features and changes in this latest edition. First, we have added a new Data Analytics in Accounting feature that highlights how companies used data analytics in the business environment. We also offer accompanying Data Analytics projects in MyLab Accounting for your students to learn how to apply data analytics to accounting problems. Financial Chapter 5 (Merchandising Operations) has been updated to provide better clarity and understanding based on the revised revenue recognition standard. All chapters went through a significant review with a focus of clarifying current coverage and expanding on content areas that needed more explanation.

We look forward to hearing from you and welcome your feedback and comments. Please do not hesitate to contact us at HorngrensAccounting@pearson.com or through our editor, Michael Trinchetto, Michael.Trinchetto@pearson.com.

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Brenda Mattison appreciates the loving support of her family, especially from her husband, Grant. She also appreciates the support she receives from so many colleagues who share their experiences and encouragement. This book is dedicated to her students, who work hard to achieve their dreams, and inspire her to continuously seek ways to improve her craft of teaching.

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