

PART ONE

OVERVIEW OF ACCOUNTING AND ITS ROLE IN THE ORGANIZATION

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CHAPTER 1

INTRODUCTION

The intention of this book is to give the accountant the answers to the largest possible number of accounting issues that are likely to arise. Thus, given the wide-ranging scope of this work, the reader should know about its overall structure in order to locate information more easily.

The *Ultimate Accountant's Reference* is divided into seven parts, each of which deals with a different aspect of the accounting function. The first part covers the role of accounting within the modern corporation. Chapter 2, *The Role of Accounting*, describes the primary tasks for which the accountant is responsible, as well as ethical concerns, and lists the job descriptions of the major positions to be found within the accounting department.

The second part deals with accounting rules and regulations. Chapter 3, *Standard-Setting Organizations*, describes the origins and responsibilities of the various rule-setting bodies that have created Generally Accepted Accounting Principles (GAAP), not only for United States business entities, but also for government and international organizations. Chapter 4, *The Securities and Exchange Commission*, gives an overview of the Securities and Exchange Commission (SEC), the EDGAR online reporting system, Staff Accounting Bulletins, and the Acts and SEC regulations that govern the reporting requirements of publicly held corporations. Chapter 5 describes a multitude of Laws that have a direct or indirect impact on accounting.

The third part covers the general format and rules governing the information contained within accounting reports. Chapter 6, *The Balance Sheet and Statement of Stockholders' Equity*, describe the format of the balance sheet and statement of retained earnings, as well as the definitions of the various categories of assets, liabilities, and equity items that are listed in these reports. Chapter 7, *The Income Statement*, describes the format of the income statement, as well as the rules governing the presentation of information about discontinued operations, earnings per share, gains and losses, accounting changes, discontinued operations, extraordinary items, other comprehensive income, and prior period adjustments. Chapter 8, *The Statement of Cash Flows*, describes the format of the statement of cash flows, as well as exemptions from its use and how to handle foreign currency translations when constructing it. Chapter 9, *Footnotes*, describes a broad range of disclosures that an accountant may be required to attach to the financial statements in the form of footnotes. Chapter 10, *Internal Management Reports*, departs from the previous chapters in this part, in that it describes reports that are entirely "free form," designed entirely for internal use and not prescribed in format by any accounting pronouncement. These include status, margin, cash, sales and expense, and payroll reports. Chapter 11, *Foreign Currency Translation*, which covers the proper treatment of foreign currency translation, including the use of the current rate translation method and the remeasurement method, as well as the proper accounting for foreign exchange sale transactions and the recognition of translation adjustments. Chapter 12, *Cash, Prepaid Expenses, and Investments*, defines

4 Part One Overview of Accounting and Its Role in the Organization

cash and investments, describes the different types of marketable securities, derivatives, and long-term investments, and how each one is accounted for.

The fourth part departs from the reporting format of the financial statement and delves into the accounting rules and transactions for each of the asset, liability, equity, and revenue categories. Chapter 13, Inventory, describes the types of inventory, inventory management, how to install an inventory tracking system, the physical inventory counting procedure, and the use of the LIFO, FIFO, average, retail, dollar-value LIFO, and gross margin methods for valuing inventory. The chapter also describes the lower of cost or market rule and the process to follow when allocating overhead costs to inventory. Chapter 14, Accounts Receivable, describes the accounts receivable transaction flow, as well as how to account for factored accounts receivable, sales returns, early payment discounts, long-term accounts receivable, and bad debts. Chapter 15, Fixed Assets, describes the use of a capitalization limit when accounting for newly acquired fixed assets, as well as the proper accounting for newly acquired assets, improvements to existing assets, the disposition of assets, construction in progress, and leasehold improvements. It also covers the various types of depreciation that may be used to account for the gradual reduction in value of fixed assets.

Chapter 16, Current Liabilities and Contingencies, describes the accounts payable transaction flow, and how to account for the period-end cutoff of accounts payable transactions. It also covers the proper accounting for advance payments from customers, accrued expenses, unclaimed wages, interest payable, dividends, termination benefits, estimated product returns, and contingent liabilities. Chapter 17, Debt, describes basic bond transactions and accounting for a bond discount or premium, as well as for non-interest-bearing notes payable. It also covers interest risk management, noncash debt payments, early debt retirement, callable debt, defaulted debt, warrants, sinking funds, bonds converted to equity, and short-term debt that is being refinanced. Chapter 18, Equity, covers the transactions related to common stock, as well as stock options, stock appreciation rights, stock warrants, dividends, stock subscriptions, stock splits, stock retirement, and employee stock ownership plans. Chapter 19, Stock Options, describes the two methods available to account for stock option transactions. Chapter 20, Revenue, covers the multitude of revenue recognition rules, including variations under the accrual method, cash method, installment sales method, completed contract method, percentage of completion method, proportional performance method, production method, and deposit method. It also discusses the special rules related to bill and hold transactions, brokered transactions, appreciation, and initiation fees. Chapter 21, Research and Development, describes the proper accounting for in-house R&D costs, as well as for acquired R&D costs, R&D costs contracted to another party, and the special case of R&D costs in the software industry. Chapter 22, Leases, describes the accounting for both the lessee and lessor, as well as for special situations such as lease extensions, terminations and subleases.

Chapter 23, Earnings per Share, addresses the proper calculation of earnings per share information, as well as its disclosure in the financial statements. Chapter 24, Segment Reporting, describes the rules for determining business segments, as well as how relevant segment information is to be presented in the financial statements. Chapter 25, Interim Reporting, covers the reporting and disclosure requirements for interim periods. Chapter 26, Accounting Changes and Correction of Errors, addresses the types of retroactive reporting changes required when accounting principles are changed or errors are discovered.

The fifth part of the book covers the crucial area of accounting management. This is the core function for many accountants, who can provide value to the organization through the use of better control systems, financial analysis of key investments, and higher levels

of departmental efficiency. Chapter 27, Best Practices, covers several dozen of the most common best practices that can improve a company's performance, including the areas of accounts payable, collections, commissions, filing, financial statements, the general ledger, invoicing, management, and payroll. For a thorough treatment of this topic, the reader can also consult the author's *Accounting Best Practices*, 6th Edition (John Wiley & Sons, 2010). Chapter 28, Budgeting, explains the system of interlocking departmental budgets, and presents a sample budget. It also covers a number of budgeting best practices and control systems that assist the accountant in creating a budget in the most efficient manner possible. Chapter 29, Closing the Books, focuses on the various steps required to achieve a fast close, and also describes the steps needed to achieve an instantaneous close. Chapter 30, Control Systems, presents a list of the most essential control points that the accountant should be concerned with, as well as control flowcharts showing where these controls are used. It also discusses the times when it may be appropriate to eliminate controls for efficiency reasons, and covers the various types of fraud that some of these controls are designed to detect and mitigate. Chapter 31, Cost Accounting, focuses on the many types of advanced data collection systems that can be used to compile data for use by cost accounting systems. It also describes the major costing systems that can be used to interpret this data, such as job costing, process costing, standard costing, direct costing, and activity-based costing. It also covers the concepts of throughput accounting, target costing, by-product costing, and cost variances. These topics are covered in more detail in the author's *Cost Accounting* (John Wiley & Sons, 2001). Chapter 32, Financial Analysis, describes how to calculate a company's cost of capital, determine which unprofitable products to eliminate, discount future cash flows, and conduct both breakeven and risk analyses. These topics and more are described in additional detail in the author's *Financial Analysis*, 2nd Edition (John Wiley & Sons, 2007). Finally, Chapter 33, Records Management, deals with the cost of various types of recordkeeping systems, the policies and procedures required for proper record storage, and the types of tax records that must be kept on hand.

The sixth part of the book deals with financial management, which includes customer credit, cash management, long-term financing, and risk management—all topics that are of particular interest to accountants in smaller organizations that do not have separate finance departments. Chapter 34, Customer Credit, describes the types of selling terms that can be extended, how to conduct a credit investigation, and various techniques for collecting overdue accounts receivable. Chapter 35, Financing, describes how to minimize a company's financing needs through proper management, how to deal with banks, and the pros and cons of delaying payments to suppliers. It also addresses the use of factoring and field warehouse financing, floor planning, inventory reduction, leasing, lines of credit, asset-based loans, bonds, bridge loans, preferred stock, sale and leaseback arrangements, and various types of debt in order to deal with a company's financing requirements. Chapter 36, Cash Management, describes the use of a cash-forecasting model and its automation, various cash concentration strategies, and how to invest short-term funds. Chapter 37, Foreign Exchange Management, describes the foreign exchange process and how one can mitigate associated risks. Chapter 38, Risk Management, describes the risk management policies and procedures that can be used to determine and mitigate risks, as well as the types of insurance that are available to reduce any remaining risks. It also describes the claims administration process, claims documentation, and the format of the annual risk management report.

The seventh part of the book deals with four major topics that do not fit easily into any of the preceding categories—mergers and acquisitions, the initial public offering, bankruptcy, and taxation. In Chapter 39, Mergers and Acquisitions, we cover the accounting required

6 Part One Overview of Accounting and Its Role in the Organization

to record a business combination under both the purchase and pooling methods of accounting. The chapter also describes how to record investments in a subsidiary by using the cost method, equity method, or consolidation method. It also delves into types of acquisitions, push-down accounting, leveraged buyouts, spin-off transactions, and the proper treatment of goodwill. Chapter 40, The Initial Public Offering, covers the entire IPO process, including preparation, finding an underwriter, registering the IPO, and listing on an exchange. Chapter 41, Going Private, describes the process for taking a public company private. Chapter 42, Bankruptcy, covers the sequence of events in a bankruptcy, as well as the rights of all parties and a variety of special issues. Chapter 43, Taxation, covers over 40 taxation issues, including the Alternative Minimum Tax, partnership taxation, deferred compensation, stock options, and transfer pricing.

The final part of this book is the appendices, which include additional reference information that the accountant is likely to require on a regular basis. Appendix A describes the different types of account code structures that can be used in a chart of accounts, and gives sample charts of accounts for each structure. Appendix B contains a list of nearly all journal entries that an accountant is likely to deal with. Appendix C contains interest rate tables, as well as the formulas used to derive them. These tables cover simple interest, compound interest, the present value of an annuity, and the future amount of an annuity. Appendix D contains more than 40 ratios that can be used to determine a company's financial condition. For more ratios, please consult the author's *Business Ratios and Formulas* 2nd Edition (John Wiley & Sons, 2007). The final appendix includes a complete list of due diligence questions to ask when reviewing a potential acquisition.

In short, *The Ultimate Accountants' Reference* is a complete source of information for the practicing accountant. By using the table of contents, this introduction, and the index to locate information, one can find the answers to most everyday accounting questions in this book.