

Chapter 7: Accounting Procedures Part II

Overview

This chapter presents a variety of additional topics related to accounting procedures. While some of the topics are unrelated to one another, they all offer information that is very important to the accounting process for business. This chapter does not present the numeric examples, but it does not reduce the importance of the topics.

Lecture Notes

A. Additional Topics

1. A voucher system is used to obtain the maximum amount of internal control over cash disbursements, purchasing, and receiving; it requires that a voucher be prepared and verified prior to making any payments.

- a. The **Voucher System** includes a process for working with vouchers. Vouchers authorize the payment of a liability. It includes information for the date, information from the invoice, ledger accounts used, and spaces for signatures; the vouchers are numbered consecutively.
- b. **Recording Transactions** in the system includes these steps:
 1. An invoice is received, and a voucher is prepared containing all necessary information.
 2. The voucher is verified by the appropriate individuals.
 3. The accounting department indicates which accounts are used in the transaction (debits and credits).
 4. An official confirms that the verification has been complete and the liability is valid.
 5. The voucher is then entered into a voucher register; the register is used to record all types of expenditures (replaces the purchases journal in a voucher system).
 6. When payment is made, it is recorded in the register, and columns are totaled and posted.
 7. Paid vouchers are filed in a special file (numerically).

2. Payroll Accounting

- a. **Income Tax** is required to be withheld for federal taxes, sometimes for state and local taxes (if applicable). Periodic payments must be recorded and made to the proper agencies.
- b. **FICA Tax** is withheld at a specific percentage unless an employee's earnings reach a maximum. The 2003 rate was 6.2% on the first 87,000 earned (0% after that); therefore, anyone making less than \$87,000 would pay FICA on their entire earnings for the year.
- c. **Medicare** (Federal Hospital Insurance) is paid by both the employer and employee at a rate of 1.45% of the employee's earnings.
- d. **Voluntary Deductions** include things like insurance, pension plans, and savings bonds.

- e. **Employer Payroll Expenses** are also recorded.
 1. Social security tax (FICA) is also paid by the employer at an equal rate.
 2. Federal unemployment taxes are paid as a percentage of employee earnings.
 3. State unemployment tax is also levied on the employer; very few states tax the employee. There may be a reduced percentage for companies that have not had claims on the unemployment system.
 4. Employee fringe benefits can be very expensive; they include things like vacation, insurance, retirement plans, and holiday pay.
 - f. **Accrual of Taxes and Expenses** is necessary at the end of an accounting period to match revenue and expenses.
 - g. **Payroll Liabilities** are current liabilities.
 - h. **Quarterly Reports** are filed to show the amounts withheld for federal income tax and FICA; the frequency of deposits depends on amounts withheld.
3. Confidentiality
- a. **Employee Responsibilities** relate to payroll and other company information that should be kept confidential unless authorized or legally required to share.
 - b. **Employee Privacy Issues** have evolved over time.
 1. Lie detector tests are prohibited by the Employee Polygraph Protection Act of 1988.
 2. Drug testing procedures are still being set, but there is a dramatic increase in the use of drug testing in the workplace. The Drug-Free Workplace Act of 1988 has played a role.
 3. Privilege against defamation is protected because of the increase of lawsuits filed by former employees; therefore, limited information is shared in reference checks.
 4. Intrusions into personal privacy are prohibited, if they are unreasonable.
4. Income Taxes
- Taxable income is calculated using this formula:
 Income – Adjustments = Adjusted Gross Income
 Adjusted Gross Income – Personal and Dependency Exemptions – Itemized or Standard Deductions = Taxable Income
- a. **Income** includes wages, salaries, tips, taxable interest income, dividend income, taxable tax refunds (state and local), alimony, business income, capital gains, rent, bonuses, royalties, along with other sources. *Remind students to be sure they understand your personal situation related to what counts and what doesn't.*
 - b. **Gains and Losses** from property transactions may be recognized for taxes; gains are usually recognized, but losses may not be.
 - c. **Capital Gains** are classified before determining their impact on taxes.
 1. Short-term capital gains or losses result from disposing of capital assets held for one year or less.

2. Long-term capital gains or losses result from disposing of capital assets held for more than one year.
 3. Net short-term capital gains or losses are used to offset one another.
 4. Taxing of net capital gains often results in special tax benefits; the rules change frequently.
 5. Deduction of net capital losses maxes out at \$3,000 per year; an unused amount can be carried forward.
- d. **Deductions** are allowed in figuring the adjusted gross income.
1. Some of the adjustments include those for business expenses, non-reimbursed employee expenses, penalties, alimony, capital loss, some IRA payments, and certain retirement plan contributions.
 2. Itemized deductions for personal expenses include medical expenses in excess of 7.5% of the AGI, real estate taxes, personal property taxes, interest on home loans, charitable contributions, casualty and theft losses, moving expenses, and job expenses.
5. **Licensing Agreements**
- Licensing agreements are also called franchises; one party allows another party to use the trade name, trademark, commercial symbols, copyrights, and other property in the distribution or selling of goods.
- a. **Private Sector** can grant licenses to a licensor (franchisee) for several reasons:
 1. A licensor can manufacture a product and license a dealer to distribute it to the public.
 2. A licensor may license someone to manufacture and distribute in certain regions.
 3. A licensor may license someone to make a product and sell it to the public from a retail outlet serving a specific area.
 - b. **Government** may grant licenses for several reasons:
 1. Some states require a license for certain types of businesses; it includes a license tax. Examples of such licenses include accountants, lawyers, doctors, restaurants, and liquor stores.
 2. Some municipalities require a license to use public property (land, roads, airways) to perform a service.
6. **Leasing**
- A lease outlines the conditions of renting property to others.
- a. The **Nature of a Lease** is both a contract and conveyance of real property. The lessee takes possession rights for a specific period of time from the lessor in exchange for cash payments.
 - b. **Operating Leases** are short-term; the lessee takes possession, but the lessor maintains ownership.

1. The lessor records the receipt of rent as a debit to Cash and a credit to Rent Revenue.
 2. The lessee records the payment of rent as a debit to Rent Expense and a credit to Cash.
- c. **Capital Leases** are long-term and non-cancelable; it is treated as an installment purchase.
1. It must meet at least one of the criteria below:
 - The lease transfers ownership to the lessee at the end of the lease term.
 - The lease contains a bargain purchase option.
 - The lease term is equal to 75% or more of the useful life of the asset.
 - The present value of the lease payment is 90% or more of the market value of the asset.
 2. Accounting for a capital lease is done as if the asset were purchased.
7. **Contracts**
- The legal principles used to determine what agreements are enforceable are demonstrated in the law of contracts.
- a. **Common Law** provided the origin for contract law; laws are set by states.
 - b. **Uniform Commercial Code (UCC)** has been adopted by all states to promote greater conformity in interstate commercial transactions.
 - c. **Elements** of a contract include:
 1. Legality—the agreement must be legal in subject and purpose.
 2. Mutuality—parties must indicate there is agreement between them.
 3. Consideration—there must be something of value exchanged for something of value.
 4. Capacity of parties must be present.
 5. The agreement must conform to the requirements/form required by law.
 - d. Basic **Types** of contracts include:
 1. A quasi-contract is not a contract because there is no mutual assent; the law imposes the obligation. This type of contract exists to prevent unjust enrichment of a party.
 2. A unilateral contract is one in which the offer is accepted by performance of the requested act, not by a return promise.
 3. A bilateral contract involves an exchange of promises.
 4. An implied contract is one in which the agreement is expressed by conduct instead of words.
 - e. The **Statute of Limitations** is five years for an oral contract and ten years for one that is written.
8. **Currency**
- a. **Money** refers to the coins, currency, and checking account balances that are available for use.

- b. **Components** of the money supply include:
 1. Coins and currency constitute about 27% of the money supply. Federal Reserve notes are no longer backed by any commodity.
 2. Transaction deposits include those in checking accounts (and other bank accounts), which make up about 73% of the money supply.
 3. Near monies consist of balances in savings accounts and other things that can easily be converted to cash. In their present form, however, they do not serve as money.
 4. Credit cards are access to credit, not money.
- c. There are four basic **Functions** of money in an economic system.
 1. As a standard of value, it eliminates the need to compare one commodity to another.
 2. It is a medium of exchange; it is accepted in all transactions of goods and services bought and sold.
 3. It is a store of value; a way to reserve funding for the future.
 4. It is a standard of deferred payment; it allows agreements to be made for future payments.
- d. The **Value of Money** is determined by how much it can buy.
 1. Changes in the value are explained by the commodity theory, the quantity theory, and the income theory. *Review those theories in the text.*
 2. The decline in purchasing power of a dollar benefits debtors since the purchasing power for paying debts is less than when it was borrowed.

9. International Trade

- a. It is **Fundamental**: All countries engage in some form of international trade because they are better off after the trade than before it.
 1. International trade exists because of the differences in capabilities and what is available in different countries.
 2. The composition, pattern, and direction of trade is impacted by the available resources for production, economics of large-scale production, and transport costs.
 3. Foreign exchange rates for currency affect demand for foreign goods.
 4. The economic result of international trade is a reduced opportunity cost on those goods where they have a cost disadvantage.
 5. International trade is very important in the world; it amounts to 7 to 12% of world income; it is even more important for some countries.
 6. The U.S. is the world's largest exporter and importer; however, it is a small portion of the gross domestic product.
- b. The **Economic Basis of International Trade**

1. Geographic specialization is based on the premise that differences in production capabilities lead to differences in comparative costs for production, and increased efficiency and standards of living.
 2. Absolute advantage illustrates the benefits of interregional and international trade while comparative advantage refers to the ability to produce a good at a lower opportunity cost than others; specialized production.
 3. The establishment of trade is determined by terms set by the parties.
 4. The value of establishing trade provides for reallocation of resources and equalization of cost and price differences.
- c. **Special Problems of International Trade** lead to countries minimizing the amount they need to do.
1. Domestic policy may cause exchange rate problems, inflation often increases the demand for imports, and barriers may be imposed to reduce imports (tariffs, quotas, embargoes).
 2. Nationalism interferes with and restricts trade; it goes against the belief in self-sufficiency.
- d. **International Finance** is the movement of money from one country to another.
1. The balance of payments is an annual summary using a double-entry accounting system (debits equal credits).
10. Foreign Exchange can be summarized with the following points.
- a. Payment for imports must be in foreign money, which is obtained through exports, borrowing, gifts, and liquidation of foreign assets.
 - b. Export of goods and services is a long-term source of foreign dollars.
 - c. An import surplus (unfavorable balance of trade) creates need for financing.
 - d. Long-term international capital movements ranks second in importance to international imports and exports.
 - e. Restrictions to international trade:
 1. Tariffs are taxes levied on products as they go through customs. There are various types that protect the domestic industry and source of revenue; they include ad valorem tariffs, specific tariffs, and compound tariffs.
 2. Quotas put a limit on amount or value of imports or place tariffs at a certain level of imports. An embargo doesn't allow any units of that commodity to be imported (or exported).
 3. General restrictions may be placed on imports or exports from certain countries.
 4. Economic effects of tariffs and quotas change the price-cost condition or comparison of importing and exporting and the short- and long-term effects on both countries. *Review the arguments for and against tariffs and quotas in the text.*

Additional Resources for Students

Recommended readings (no texts should be more than two years old):

- Ainsworth, Penne, Dan Deines, R. David Plumlee, and Cathy Xanthaky Larson. *Introduction to Accounting: An Integrated Approach*. Richard D. Irwin, Inc.
- Fess and Warren. *Accounting Principles*. South-Western Publishing Co.
- Horngren, Charles T., Walter T. Harrison Jr., and Michael A. Robinson. *Accounting*. Prentice-Hall, Inc.
- Jones, Kumen, Michael Werner, Katherine P. Terrell, and Robert Terrell. *Introduction to Accounting: A User Perspective*. Prentice-Hall, Inc.
- Larson, Kermit D. and Barbara Chiappetta. *Fundamental Accounting Principles*. Richard D. Irwin, Inc.
- Needles, Belverd E. Jr., Henry R. Anderson, James C. Caldwell, and Sherry K. Mills. *Principles of Accounting*. Houghton Mifflin Company.
- Weygandt, Jerry, Donald Kieso, and Walter Kell. *Accounting Principles*. John Wiley & Sons, Inc.

Current issues of periodicals or business publications are also an excellent resource. Some of the following periodicals have an accompanying Web site.

Current Periodical	Web Address
<i>IAAP Complete Office Handbook</i>	http://www.iaap-hq.org/products/handbook.htm
<i>Modern Office Technology</i>	
<i>OfficePro</i>	http://www.iaap-hq.org/officepro/toc.htm
<i>The Office</i>	
<i>Financial Accounting Standards Board</i>	http://www.fasb.org
<i>American Institute of CPAs</i>	http://www.aicpa.org
<i>American Association of Accounting</i>	http://aaahq.org