

WARREN | REEVE | DUCHAC

# Corporate Financial Accounting



# Corporate Financial Accounting <sup>14e</sup>

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## Roadmap for Success

Warren/Reeve/Duchac *Corporate Financial Accounting, 14e*, makes it easy for you to give students a solid foundation in business and accounting. Warren/Reeve/Duchac covers the fundamentals AND motivates students to learn by showing how accounting is important to a business.

Warren/Reeve/Duchac is successful because it reaches students with a combination of new and tried-and-tested pedagogy.

This revision includes a range of exciting new and existing features that help Warren/Reeve/Duchac provide students with the context to see how accounting is valuable to business. These include:

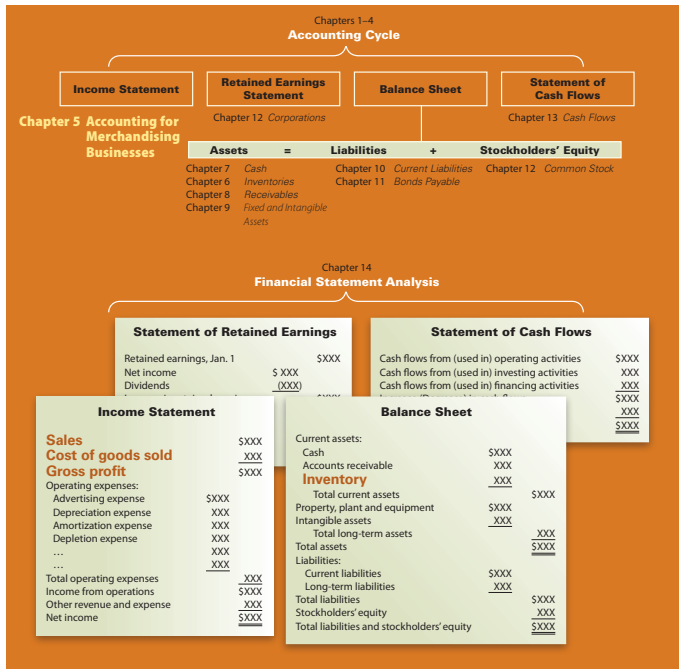
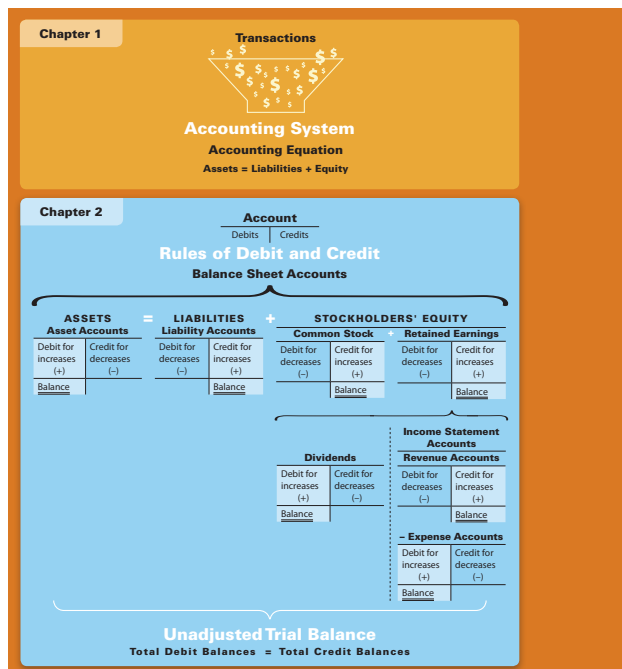
- New! Schema
- New! Links to Business
- New! Why It Matters
- New! Analysis for Decision Making & Make a Decision
- New! Accounting Equation Impacts added beside journal entries

Warren/Reeve/Duchac also includes a thorough grounding in the fundamentals that any business student will need to be successful. These key features include:

- Stepwise approach to accounting cycle
- Presentation style designed around the way students learn
- New! Check Up Corner
- New! Let's Review

### Hallmarks of the revision include:

- At the start of each chapter, a **schema, or roadmap, shows students what they are going to learn and how it is connected to the larger picture.** In the early chapters, the schema shows how the steps in the accounting cycle are interrelated. In later chapters, the schema shows how each chapter's topics are connected to the financial statements.



*"I do a similar thing in class mapping out where they are in the book. I generally use a balance sheet and mark it up like a 'map at the mall and you are here.' This does a similar thing."*

*– Patricia Worsham, California State Polytechnic University, Pomona*

*"The schema shows the 'big picture.' It connects all the chapters. Students need help seeing the big picture and the connection."*

*– Gloria Sanchez, Mt. San Jacinto College*

- **Link to the "opening company" of each chapter** calls out examples of how the concepts introduced in the chapter are connected. **This shows how accounting is used in the real world by real companies.**



### McDonald's

McDonald's began in 1940 in San Bernardino, California, as a Bar-B-Q restaurant operated by two brothers, Dick and Mac McDonald. In 1954, Ray Kroc visited the restaurant and convinced the McDonald brothers to let him franchise its operations nationwide. Ray Kroc opened his first McDonald's in Des Plaines, Illinois, in 1955, with its distinguishing, newly designed Golden Arches. Today, McDonald's operates in more than 100 countries, has more than 30,000 restaurants, employs more than 400,000 people, has sold billions of hamburgers, and generates yearly revenues in excess of \$27 billion.

Would you like to own and operate a McDonald's restaurant? McDonald's grants 20-year franchises to individuals who want to become owner/operators of a restaurant. Individuals may purchase either an existing or a new restaurant. When opening a new restaurant, the owner must invest in the store equipment, signs, seating, and décor. The company normally

owns the land and the building. McDonald's also provides training for its owner/operators. In return, the company is paid a monthly service charge, which is either a fixed amount or a percent of sales. The total cost of opening a new restaurant may exceed several million dollars.

Obviously, the decision to open a McDonald's restaurant is a major commitment with long-lasting implications. This chapter discusses the accounting for investments in long-term, fixed assets such as a new restaurant. This accounting addresses such issues as how much of the investment should be recorded as an asset, how much should be written off as an expense each year, and how the disposal of a fixed asset should be recorded. Finally, accounting for natural resources, such as mineral deposits, and intangible assets, such as patents and copyrights, are discussed.

Source: www.aboutmcdonalds.com

McDonald's recently reported that it is the lessee in over 14,000 locations. The leases are normally for 20 years with an option to renew.

*Link to  
McDonald's*

The accounting for leases is currently the focus of a joint project by the Financial Accounting Standards (FASB) and the International Accounting Standards Board (IASB) to merge U.S. and international standards.<sup>2</sup> Under the proposed standard lessors and lessees would be required to record assets and liabilities related to certain long-term lease contracts.

**IFRS**  
See Appendix C for more information.

For purposes of this text, we assume that leases are short-term and not extending beyond one year. Thus, lease payments are recorded as rent by debiting Rent Expense and crediting Cash. The lease terms, such as a renewal option, may be disclosed in the notes to the financial statements. The asset rentals described in the earlier chapters of this text were accounted for in this manner.

- **NEW!** Located early in each chapter, **Why It Matters** shows students how accounting is important to businesses with which they are familiar.

## Why It Matters

### Fixed Assets

Fixed assets often represent a significant portion of a company's total assets. The table that follows shows the fixed assets as a percent of total assets for some select companies across a variety of industries.

As can be seen, the type of industry will impact the proportion of fixed assets to total assets. Retail has the highest percent of fixed assets to total assets, while social media and software are on the lower end of the scale. High-tech service companies often use fewer fixed assets to deliver their services than will companies that use stores, equipment, planes, cell towers, or theme parks.

Company	Industry	Percent of Fixed Assets to Total Assets
<b>McDonald's Corporation</b>	Food Retail	72%
<b>Target Corporation</b>	Merchandise Retail	63%
<b>Alcoa Inc.</b>	Heavy Industry	44%
<b>Delta Air Lines, Inc.</b>	Transportation	41%
<b>Verizon Communications Inc.</b>	Communications	39%
<b>The Walt Disney Company</b>	Entertainment	28%
<b>Facebook, Inc.</b>	Social Media	10%
<b>Microsoft Corporation</b>	Software	8%

Fixed assets have important properties that require management attention:

- Fixed assets require a long-term commitment. Mistakes in acquiring fixed assets can be very costly and difficult to reverse, thus managers must take special care in acquiring fixed assets.
- Fixed assets wear out over time and need to be replaced. Managers must monitor fixed assets and know when to replace fixed assets due to wear and tear, and obsolescence.
- Fixed assets need to be maintained during use. Managers need to develop maintenance programs to keep the investment in fixed assets productive.
- Fixed assets often require significant acquisition funds. Managers need to acquire funding internally or by other sources to finance the purchase of fixed assets.

*"These features show students the relevance to the business world of what they are learning and so should help motivate them to learn."*

– Steven J. LaFave, Augsburg College

*"It does a good job of bringing the materials into a 'real world' environment."*

– Bob Urell, Irvine Valley College

- To aid comprehension and to demonstrate the impact of transactions, **journal entries include the net effect of the transaction on the accounting equation.**

2019					
Jan. 3	Inventory	2,510			
	Cash		2,510		
	Purchased inventory from Bowen Co.				

$$A = L + E$$

$$+-$$

Purchases of inventory on account are recorded as follows:

Jan. 4	Inventory	9,250			
	Accounts Payable—Thomas Corporation		9,250		
	Purchased inventory on account.				

$$A = L + E$$

$$+ \quad +$$

The terms of purchases on account are normally indicated on the **invoice** or bill that the seller sends the buyer. An example of an invoice sent to **NetSolutions** by Alpha Technologies is shown in Exhibit 2.

- **The link between the journal entry and the accounting equation is also included in the accompanying CengageNOWv2 course** in the accounting cycle chapters, reminding students of the link—but not requiring them to actively make the link.

*Prepare a journal entry on June 30 for the transaction described in the instructions. Refer to the Chart of Accounts for exact wording of account titles.*

GENERAL JOURNAL						PAGE 1
JOURNAL				ACCOUNTING EQUATION		
DATE	DESCRIPTION	DEBIT	CREDIT	A	=	L + E
1 Jun. 30	Cash	550		+		
2	Notes Receivable		500	-		
3	Interest Revenue		50			+

- To aid learning and problem solving, throughout each chapter new **Check Up Corners** provide students with step-by-step guidance on how to solve problems. Problem-solving tips help students avoid common errors.

### Check Up Corner 9-1 Fixed Assets

On the first day of the year, Firefall Company acquired equipment for use in operations at a cost of \$340,000. The equipment was expected to have a useful life of four years or 1,000 hours, and a residual value of \$20,000. The equipment was used for 280 hours during the first year, 260 hours during the second year, 240 hours during the third year, and 220 hours during the fourth year.

- Determine the annual depreciation expense in each year and the book value of the equipment at the end of each year under the:
  - straight-line method
  - units-of-activity method
  - double-declining-balance method
- Assuming the equipment was sold for \$95,000 on the first day of the fourth year of operations, journalize the entry to record the sale if the equipment was depreciated under the:
  - straight-line method
  - units-of-activity method
  - double-declining-balance method

#### Solution:

1. Straight-Line Method:

$$\text{Annual Depreciation Expense} = \frac{\text{Cost} - \text{Residual Value}}{\text{Useful Life}} = \frac{\$340,000 - \$20,000}{4 \text{ Years}} = \$80,000$$

The straight-line percentage is computed as follows:

$$\text{Straight-Line Percentage} = \frac{100\%}{4 \text{ Years}} = 25\%$$

Annual depreciation expense and end-of-year book value are computed as follows:

Year	Calculation of Depreciation				End of Year		
	Straight-Line Percentage	x	Depreciable Cost	=	Annual Depreciation Expense	Accumulated Depreciation	Book Value
1	25%	x	\$320,000	=	\$80,000	\$ 80,000	\$260,000
2	25%	x	320,000	=	80,000	160,000	180,000
3	25%	x	320,000	=	80,000	240,000	100,000
4	25%	x	320,000	=	80,000	320,000	20,000

Book Value = Asset Cost (\$340,000) - Accumulated Depreciation

Ending Book Value = Residual Value

2. Units-of-Activity Method:

$$\text{Depreciation per Hour of Use} = \frac{\text{Cost} - \text{Residual Value}}{\text{Total Number of Hours}} = \frac{\$340,000 - \$20,000}{1,000 \text{ Hours}} = \$320 \text{ per Hour}$$

Annual depreciation expense and end-of-year book value are computed as follows:

Year	Calculation of Depreciation				End of Year		
	Depreciation per Hour of Use	x	Total Hours of Activity Used	=	Annual Depreciation Expense	Accumulated Depreciation	Book Value
1	\$320	x	280	=	\$89,600	\$ 89,600	\$250,400
2	320	x	260	=	83,200	172,800	167,200
3	320	x	240	=	76,800	249,600	90,400
4	320	x	220	=	70,400	320,000	20,000

Book Value = Asset Cost (\$340,000) - Accumulated Depreciation

Ending Book Value = Residual Value

"These are good, I like the step-by-step approach. I also like it when it reinforces concepts before the solution begins."

– Pam Neely, The College at Brockport, SUNY

"I like giving students the opportunity to self-test themselves for mastery of this material . . . I would use this tool for each major area in the chapter."

– Lawrence A. Roman, Cuyahoga Community College

- In each chapter, **Analysis for Decision Making** highlights how businesses use accounting information to make decisions and evaluate the health of a business. This provides students with context of why accounting is important to a business.

Analysis for Decision Making

**Objective**  
Describe and illustrate the use of the asset turnover ratio in evaluating a company's operating performance.

### Asset Turnover Ratio

The **asset turnover ratio** measures how effectively a business is using its assets to generate sales. A high ratio indicates an effective use of assets.

The asset turnover ratio is computed as follows:

$$\text{Asset Turnover Ratio} = \frac{\text{Sales}}{\text{Average Total Assets}}$$

The denominator is the average of the total assets at the beginning and end of the year. To illustrate the use of this ratio, the following data (in millions) were taken from recent annual reports of **Dollar Tree, Inc.**:

	Year 2	Year 1
Total sales	\$7,840	\$7,394
Total assets:		
Beginning of year	2,752	2,329
End of year	2,772	2,752

The asset turnover ratio for each year is as follows:

	Year 2	Year 1
Asset turnover ratio*	2.84	2.91
	$\$7,840 \div [(\$2,752 + \$2,772) \div 2]$	$\$7,394 \div [(\$2,329 + \$2,752) \div 2]$

\*Rounded to two decimal places.

Dollar Tree's asset turnover ratio decreased from 2.91 in Year 1 to 2.84 in Year 2. Thus, Dollar Tree had an insignificant decline in the use of its assets to generate sales in Year 2.

Using the asset turnover ratio for comparisons to competitors and with industry averages could also be beneficial in interpreting Dollar Tree's use of its assets. For example, the following data (in millions) were taken from a recent annual report of **Dollar General Corporation**, one of Dollar Tree's competitors:

- Following the Analysis for Decision Making segment, students have an opportunity to apply their knowledge in making decisions.



## Make a Decision Asset Turnover Ratio

**CSX Corporation** and **Union Pacific Corporation** are major railroads, operating primarily in the eastern and western portion of the United States, respectively. **YRC Worldwide Inc.** (Yellow Freight) is one of the largest trucking companies in the United States. The sales and total assets for a recent year for each company are as follows:

	CSX	Union Pacific	YRC Worldwide
Total sales	\$12,669	\$23,988	\$5,069
Total assets:			
Beginning of year	31,782	49,731	2,065
End of year	33,053	52,716	1,985

- Compute the asset turnover ratio for each company. (Round to two decimal places.)
- Which railroad is more efficient in generating revenues from its assets?
- How does YRC's asset turnover ratio compare to the two railroads? Why?

### Solution:

A.

	CSX	Union Pacific	YRC Worldwide
Asset turnover ratio	0.39	0.47	2.50
	$\$12,669 \div [(\$31,782 + \$33,053) \div 2]$	$\$23,988 \div [(\$49,731 + \$52,716) \div 2]$	$\$5,069 \div [(\$2,065 + \$1,985) \div 2]$

- Union Pacific's asset turnover ratio is 0.47, while CSX's is 0.39. Thus, Union Pacific is more efficient in using its assets in generating revenue. For every dollar of assets, Union Pacific generates 47 cents of revenue.
- YRC's asset turnover ratio is over five times larger than that of the railroads. Clearly, YRC is much more efficient in generating revenues from its total assets than are the railroads. Railroads are very capital intensive, which means that their operations require a large asset base. Railroads require track, engines, railcars, computers, and switching yards to maintain the rail system. A trucking company is much less capital intensive. A trucking company requires an investment in trucks, computers, and terminals. Trucks run on highways that are an asset of the government, whereas the railroads must own their own rails.

## Make a Decision

"I like the explanation of how to calculate the ratio and the way it's demonstrated how to calculate McDonald's – the presentation is clear and concise. Then, I really like the clear and concise answer to 'Is 1.1 efficient?' Ex 14 is great. I like the Make a Decision feature so students get to practice right away. Overall, a great section."

– Barbara Muller, Arizona State University

"This encourages students to think about how the material relates to the real world and makes them realize that the information is being collected so decisions can be made."

– Sue Cunningham, Rowan Cabarrus Community College

- Analysis for Decision Making appears at the end of chapter, enabling **instructors to assess students' analytical skills** with real world company data.

- At the end of each chapter, **Let's Review** is a new chapter summary and self-assessment feature that is designed to help busy students prepare for an exam. It includes a summary of each learning objective's key points, key terms, multiple-choice questions, exercises, and a sample problem that students may use to practice.

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## Let's Review

### Chapter Summary

1. The simplest form of an account, a T account, has three parts: (1) a title, which is the name of the item recorded in the account; (2) a left side, called the debit side; and (3) a right side, called the credit side. Periodically, the debits in an account are added, the credits in the account are added, and the balance of the account is determined. The system of accounts that make up a ledger is called a chart of accounts.
2. Transactions are initially entered in a record called a journal. The rules of debit and credit for recording increases or decreases in accounts are shown in Exhibit 3. Each transaction is recorded so that the sum of the debits is always equal to the sum of the credits. The normal balance of an account is indicated by the side of the account (debit or credit) that receives the increases.
3. Transactions are journalized and posted to the ledger using the rules of debit and credit. The debits and credits for each journal entry are posted to the accounts in the order in which they occur in the journal.
4. A trial balance is prepared by listing the accounts from the ledger and their balances. The totals of the Debit column and Credit column of the trial balance must be equal. If the two totals are not equal, an error has occurred. Errors may occur even though the trial balance totals are equal. Such errors may require a correcting journal entry.

### Key Terms

<ul style="list-style-type: none"> <li>account (54)</li> <li>account receivable (67)</li> <li>assets (56)</li> <li>balance of the account (55)</li> <li>chart of accounts (55)</li> <li>correcting journal entry (74)</li> <li>common stock (56)</li> <li>credit (55)</li> <li>debit (55)</li> <li>dividends (56)</li> </ul>	<ul style="list-style-type: none"> <li>double-entry accounting system (57)</li> <li>expenses (56)</li> <li>horizontal analysis (75)</li> <li>journal (59)</li> <li>journal entry (60)</li> <li>journalizing (60)</li> <li>ledger (55)</li> <li>liabilities (56)</li> <li>normal balance of an account (58)</li> <li>posting (63)</li> </ul>	<ul style="list-style-type: none"> <li>retained earnings (56)</li> <li>revenues (56)</li> <li>rules of debit and credit (57)</li> <li>slide (73)</li> <li>stockholders' equity (56)</li> <li>T account (55)</li> <li>transposition (73)</li> <li>trial balance (72)</li> <li>unadjusted trial balance (72)</li> <li>unearned revenue (65)</li> </ul>
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### Practice

#### Multiple-Choice Questions

1. A debit may signify a(n):
 

A. increase in an asset account.	C. increase in a liability account.
B. decrease in an asset account.	D. increase in the stockholders' equity (common stock) account.
2. The type of account with a normal credit balance is:
 

A. an asset.	C. a revenue.
B. stockholders' equity (dividend).	D. an expense.
3. A debit balance in which of the following accounts would indicate a likely error?
 

A. Accounts Receivable	C. Fees Earned
B. Cash	D. Miscellaneous Expense

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4. The receipt of cash from customers in payment of their accounts would be recorded by:
 

A. a debit to Cash and a credit to Accounts Receivable.	C. a debit to Cash and a credit to Accounts Payable.
B. a debit to Accounts Receivable and a credit to Cash.	D. a debit to Accounts Payable and a credit to Cash.
5. The form listing the titles and balances of the accounts in the ledger on a given date is the:
 

A. income statement.	C. retained earnings statement.
B. balance sheet.	D. trial balance.

*Answers provided after Problem. Need more practice? Find additional multiple-choice questions, exercises, and problems in CengageNOWv2.*

### Exercises

1. **Rules of debit and credit and normal balances** Obj. 2  
State for each account whether it is likely to have (A) debit entries only, (B) credit entries only, or (C) both debit and credit entries. Also, indicate its normal balance.
 

1. Accounts Receivable	4. Common Stock
2. Commissions Earned	5. Rent Revenue
3. Notes Payable	6. Wages Expense
2. **Journal entry for asset purchase** Obj. 2  
Prepare a journal entry for the purchase of office equipment on October 27 for \$32,750, paying \$6,550 cash and the remainder on account.
3. **Journal entry for fees earned** Obj. 3  
Prepare a journal entry on March 16 for fees earned on account, \$9,450.
4. **Journal entry for dividends** Obj. 3  
Prepare a journal entry on December 23 for dividends paid of \$20,000.
5. **Missing amount from an account** Obj. 3  
On July 1, the cash account balance was \$37,450. During July, cash payments totaled \$115,860 and the July 31 balance was \$29,600. Determine the cash receipts during July.
6. **Trial balance errors** Obj. 3  
For each of the following errors, considered individually, indicate whether the error would cause the trial balance totals to be unequal. If the error would cause the trial balance totals to be unequal, indicate whether the debit or credit total is higher and by how much.
 

A. The payment of an insurance premium of \$5,400 for a three-year policy was debited to Prepaid Insurance for \$5,400 and credited to Cash for \$4,500.
B. A payment of \$270 on account was debited to Accounts Payable for \$720 and credited to Cash for \$720.
C. A purchase of supplies on account for \$1,600 was debited to Supplies for \$1,600 and debited to Accounts Payable for \$1,600.
7. **Correcting entries** Obj. 4  
The following errors took place in journalizing and posting transactions:
 

A. Rent expense of \$4,650 paid for the current month was recorded as a debit to Miscellaneous Expense and a credit to Rent Expense.
B. The payment of \$3,700 from a customer on account was recorded as a debit to Cash and a credit to Accounts Payable. Journalize the entries to correct the errors. Omit explanations.

*Answers provided after Problem. Need more practice? Find additional multiple-choice questions, exercises, and problems in CengageNOWv2.*

- Sample multiple-choice questions allow students to practice with the type of assessments they are likely to see on an exam.
- Short exercises and a longer problem allow students to apply their knowledge.
- Answers** provided at the end of the Let's Review section let students check their knowledge immediately.
- Algorithmic practice activities in the accompanying CengageNOWv2 allow students to regenerate a practice activity at will.

"I like the idea that they're within the chapter and immediately after the specific chapter topic. Also, they're easy and promote a sense of accomplishment and understanding in the student."

— John Seilo, Irvine Valley College

- **Take It Further** in the end-of-chapter activities allows instructors to assign other special activities related to ethics, communication, and teamwork.

## Take It Further



ETHICS

### TIF 11-1 Ethics in Action

CEG Capital Inc. is a large holding company that uses long-term debt extensively to fund its operations. At December 31, the company reported total assets of \$100 million, total debt of \$55 million, and total equity of \$45 million. In January, the company issued \$11 billion in long-term bonds to investors at par value. This was the largest debt issuance in the company's history, and it significantly increased the company's ratio of total debt to total equity. Five days after the debt issuance, CEG filed legal documents to prepare for an additional \$50 billion long-term bond issue. As a result of this filing, the price of the \$11 billion in bonds that the company issued earlier in the week dropped to 94 because of the increased risk associated with the company's debt. The investors in the original \$11 billion bond issuance were not informed of the company's plans to issue additional debt so quickly after the initial bond issue.

➡ Did CEG Capital act unethically by not disclosing to initial bond investors its immediate plans to issue an additional \$50 billion debt offering?



REAL WORLD

### TIF 11-2 Team Activity

In teams, select a public company that interests you. Obtain the company's most recent annual report on Form 10-K. The Form 10-K is a company's annually required filing with the Securities and Exchange Commission (SEC). It includes the company's financial statements and accompanying notes. The Form 10-K can be obtained either (A) from the investor relations section of the company's Web site or (B) by using the company search feature of the SEC's EDGAR database service found at [www.sec.gov/edgar/searchedgar/companysearch.html](http://www.sec.gov/edgar/searchedgar/companysearch.html).

1. Based on the information in the company's most recent annual report, answer the following questions:
  - A. How much long-term debt does the company report at the end of the most recent year presented?
  - B. Does the company have any bonds outstanding at the end of the most recent year? If so, read the supporting notes to the financial statements and determine:
    - (1) The contract rate of interest on the bond issue(s).
    - (2) The discount or premium on the bond issue(s).
    - (3) The due date of the bond issue(s).
    - (4) The total amount of any bonds that will mature within one year of the balance sheet date.
2. ➡ Based on your answers to the questions in requirement 1, evaluate the company's debt position.

## Other Features

- In Chapter 3, The Adjusting Process, the discussion of the Nature of the Adjusting Process has been significantly revised to facilitate student understanding. The revision includes a discussion of the cash and accrual basis as well as revenue and expense recognition. Exhibit 1 "Accruals" and Exhibit 2 "Deferrals" have been added to this section to clearly describe and summarize why accruals and deferrals require adjustments.
- By presenting and discussing accruals first followed by deferrals, we go from "simple to complex."
- The remainder of the chapter has been reorganized so that accruals (accrued revenue, accrued expenses) are discussed first, which are the simplest of adjusting entries. Next, deferrals (unearned revenue, prepaid expenses) are discussed, which are the more complex set of adjusting entries.
- As before, depreciation is discussed last followed by a summary of the adjusting process.



## CengageNOWv2

CengageNOWv2 is a powerful course management and online homework resource that provides control and customization to optimize the student learning experience. Included are many proven resources, including algorithmic activities, a test bank, course management tools, reporting and assessment options, and much more.

## Closing the Gap between Homework and Exam Performance

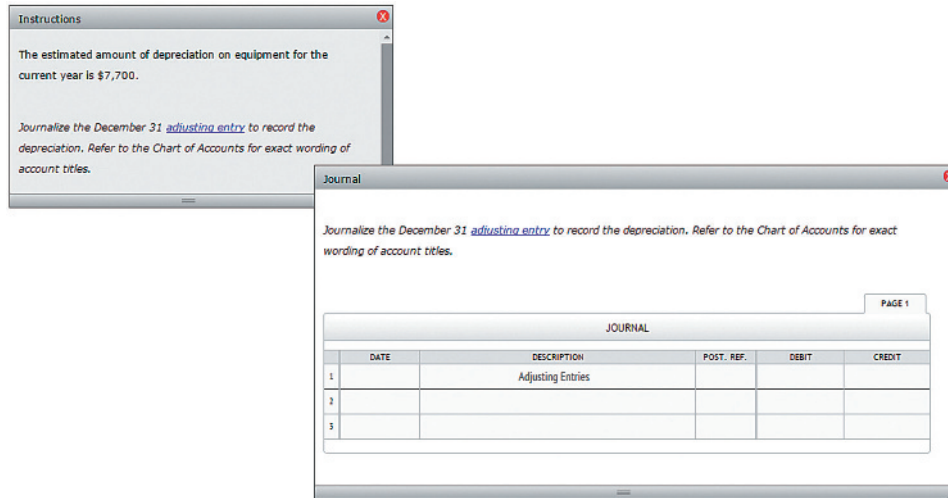
Many students perform well on homework but struggle when it comes to exams. Now, with the new Blank Sheet of Paper Experience, students must problem-solve on their own, just as they would if taking a test on a blank sheet of paper.

## Blank Sheet of Paper Experience

A less-leading Blank Sheet of Paper Experience discourages overreliance on the system.

- Instructors may choose between Learning Problems that guide student learning via drop-down menus, or they may use Blank Sheet of Paper problems.
- In Blank Sheet of Paper items, students must refer to the Chart of Accounts and decide for themselves which account is impacted.

- The number of accounts in each transaction is not given away.
- Whether the account should be debited or credited is not given away.
- Transactions may be entered in any order (as long as the entries are correct).
- Check My Work feedback only reports on what students have actually attempted, which prevents students from “guessing” their way through the assignment.



- **New!** The link between the journal entry and the accounting equation is also included in the accompanying CengageNOWv2 course in the accounting cycle chapters, automatically reinforcing students of the link—but not requiring them to actively make the link.

*Prepare a journal entry on June 30 for the transaction described in the instructions. Refer to the Chart of Accounts for exact wording of account titles.*

GENERAL JOURNAL					ACCOUNTING EQUATION				
JOURNAL									
DATE	DESCRIPTION	DEBIT	CREDIT	A	=	L	+	E	
1 Jun. 30	Cash	550		+					
2	Notes Receivable		500	-					
3	Interest Revenue		50					+	

*“As they are creating their journal entry, this will allow them to see when they debit or credit an account the effect it has on the accounting equation. If they are not sure of the debit or credit, this might help them to figure it out.”*

*– Cecile Roberti, Community College of Rhode Island*

*“With the Accounting Equation impact automatically recorded, the student sees the impact, which I think is a better learning tool than having an additional step to completing the journal entry. The student sees the cause and effect, which for a beginning accounting student would help to increase understanding.”*

*– Sally Whitney, Colorado State University*

## Unprecedented Flexibility

In addition to Blank Sheet of Paper activities, instructors also have the option of assigning—or using in class for demonstration purposes—learning assignments that guide student learning via specially designed drop-down menus. Instructors can now carefully tailor their assignments to the needs of their students at that moment.

Prepare a journal entry for the purchase of office equipment on February 12 for \$16,150, paying \$3,200 cash and the remainder on account. If an amount box does not require an entry, leave it blank.

The screenshot shows a journal entry form with a date of Feb. 12. A dropdown menu is open, listing the following accounts: Accounts Payable, Accounts Receivable, Cash, Office Equipment, Office Equipment Expense, and Owner, Capital. The form has columns for DEBIT and CREDIT, with some cells shaded green.

## Multi-Panel View

The new Multi-Panel View in CengageNOWv2 enables students to see all the elements of a problem on one screen.

- Students make connections and see the tasks as connected components in the accounting process.
- Dramatically reduced scrolling eliminates student frustration.

With the ability to move and resize journals, ledgers, forms, and financial statements, it is easier to navigate the problem and understand the accounting system.

## Adaptive Feedback

Adaptive Feedback in CengageNOWv2 responds to students based upon their unique answers and alerts them to the type of error they have made without giving away the answer.

The screenshot shows a journal entry form titled "Journal" with a score of 21/25. The form has columns for DATE, DESCRIPTION, POST. REF., DEBIT, and CREDIT. The entry is for Dec. 31, with Debit: Depreciation Expense (7,500.00) and Credit: Accumulated Depreciation-Equipment (7400). A feedback box is open, stating: "The amount for this account is incorrect." The feedback details are as follows:

Line	Feedback	Count
2	The amount for this account is incorrect, although you've entered the amount in the correct column.	[ 2 ]
Transaction	The debits and credits do not balance.	1-01

Additional feedback text: "This transaction was matched to the first transaction (lines 2-3) of the solution. This line was matched to the second line in the transaction."

In addition to groundbreaking, adaptive feedback, CengageNOWv2 continues to provide multiple layers of guidance to keep students on track and progressing.

- **Check My Work Feedback** provides general guidance and hints as students work through homework assignments.
- **Check My Work Feedback** in CengageNOWv2 now only reports on what students have actually attempted, which prevents them from “guessing” their way through assignments.
- **Explanations** are available after the assignment has been submitted and provide a detailed description of how the student should have arrived at the solution.



## Motivation: Set Expectations and Prepare Students for the Course

CengageNOWv2 helps motivate students and get them ready to learn by reshaping their misconceptions about the introductory accounting course and providing a powerful tool to engage students.

### CengageNOWv2 Start-Up Center

Students are often surprised by the amount of time they need to spend outside of class working through homework assignments in order to succeed. The CengageNOWv2 Start-Up Center will help students identify what they need to do and where they need to focus in order to be successful with a variety of new resources.

- **What Is Accounting?** Module ensures students understand course expectations and how to be successful in the introductory accounting course. This module consists of two assignable videos: *Introduction to Accounting* and *Success Strategies*. The Student Advice Videos offer advice from real students about what it takes to do well in the course.
- **Math Review Module**, designed to help students get up to speed with necessary math skills, includes math review assignments and Show Me How math review videos to ensure that students have an understanding of basic math skills, including:
  - Whole number operations
  - Decimal operations and rounding
  - Percentage operations and conversion
  - Fraction operations
  - Converting numbers expressed in one form to a different form
  - Positive and negative numbers
  - Ratios and averages
- **How to Use CengageNOWv2** Module focuses on learning accounting, not on a particular software system. Quickly familiarize your students with CengageNOWv2 and direct them to all of its built-in student resources.

### Motivation: Prepare Them for Class

With all the outside obligations accounting students have, finding time to read the textbook before class can be a struggle. Point students to the key concepts they need to know before they attend class.

- **Video: Tell Me More.** Short Tell Me More lecture activities explain the core concepts of the chapter through an engaging auditory and visual presentation. Available either on a stand-alone basis or as an assignment, they are ideal for all class formats—flipped model, online, hybrid, or face-to-face.

#### Financial Analysis and Interpretation: Fixed Asset Turnover Ratio

- A measure of a company's efficiency in using its fixed assets to generate revenue is the fixed asset turnover ratio. The **fixed asset turnover ratio** measures the number of dollars of sales earned per dollar of fixed assets.
- The fixed asset turnover ratio is computed as follows:
 
$$\text{Fixed Asset Turnover Ratio} = \frac{\text{Sales}}{\text{Average Book Value of Fixed Assets}}$$
- The higher the fixed asset turnover, the more efficiently a company is using its fixed assets in generating sales. **the better a company is at using its fixed assets**

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- NEW Adaptive Study Plan** in CengageNOWv2 is an assignable/gradable study center that adapts to each student's unique needs and provides a remediation pathway to keep students progressing. With the NEW Adaptive Study Plan, they can focus on learning new topics and fully understanding difficult concepts.

The screenshot displays the CengageNOWv2 Adaptive Study Plan interface for Chapter 9: Fixed Assets and Intangible Assets. The interface includes a navigation bar with 'Home', 'Courses', 'Users', 'Assignments', 'Gradesbook', and 'Study Tools'. The main content area is divided into two columns: 'Objectives' and 'Activities'. The 'Objectives' column lists seven learning objectives, with the third objective, 'Journalize entries for the disposal of fixed assets', highlighted. The 'Activities' column lists five activities, including 'eBook - 9.3: Disposal of Fixed Assets' and 'I'll Be More: Journalize entries for the disposal of fixed assets'. A 'Take a Quiz' button is visible in the top right corner.

## How Does It Work?

Step 1: Students take a chapter-level quiz consisting of random questions that cover both conceptual and procedural aspects of the chapter.

Step 2: Feedback is provided for each answer option explaining why the answer is right or wrong.

Step 3: Based on the quiz results, students are provided a remediation path that includes media assets and algorithmic practice problems to help them improve their understanding of the course material.

Instructors may use prerequisites that require students to achieve mastery in the Adaptive Study Plan before moving on to new material.

Using the Adaptive Study Plan, students may also review and check their knowledge with the new Practice! Activities. These items (generally one per learning objective) build application skills by allowing students to complete practice problems and “Try Another Version.”

The screenshot displays the CengageNOWv2 Adaptive Study Plan interface for Chapter 3: The Adjusting Process. The interface shows a progress bar and a 'Done' button. The main content area is titled 'Activity Take: Practice!: Effect of omitting adjustments'. Below the title, there is a question titled 'Effect of Omitting Adjustments'. The question text reads: 'For the year ending April 30, 2016, Beckinworth Medical Services Co. mistakenly omitted adjusting entries for (1) \$6,200 of supplies that were used, (2) unearned revenue of \$11,100 that was earned, and (3) insurance of \$4,400 that expired. Indicate the combined effect of the errors on (a) revenues, (b) expenses, and (c) net income for the year ended April 30, 2016.' The question is followed by three multiple-choice options: (a) Revenues: understated, \$6,200; (b) Expenses: understated, \$11,100; (c) Net Income: overstated, \$4,400. A 'Partially Correct' message is displayed, stating: 'Consider, in each situation, if the adjustment involves an expense or a revenue. A quick calculation for this would be to add the revenues not recorded and subtract the expenses not recorded. The difference would be the effect on net income. Learning Objective 3.' The interface includes a 'Submit Answer' button, a 'Try Another Version' button, and a 'Done' button.

## Provide Help Right When Students Need It

The best way to learn accounting is through practice, but students often get stuck when attempting homework assignments on their own.

- **Video: Show Me How.** Created for the most frequently assigned end-of-chapter items, NEW Show Me How problem demonstration videos provide a step-by-step model of a similar problem. Embedded tips and warnings help students avoid common mistakes and pitfalls.



**Adjusting Entries**

b. Supplies on hand at August 31, \$675.

Supplies available during August (balance of account)	\$3,000
Supplies on hand, August 31	675
Supplies used (amount of adjustment)	<u>\$ 2,325</u>

Journal					
Date	Description	Post. Ref.	Debit	Credit	
Aug 31	Supplies Expense Supplies used		2,325		2,325

<b>Assets</b> <table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <thead> <tr> <th colspan="3">Supplies</th> </tr> </thead> <tbody> <tr> <td>Bal.</td> <td style="text-align: right;">3,000</td> <td></td> </tr> <tr> <td>Aug 31</td> <td></td> <td style="text-align: right;">2,325</td> </tr> <tr> <td>Adj. Bal.</td> <td style="text-align: right;">675</td> <td></td> </tr> </tbody> </table>	Supplies			Bal.	3,000		Aug 31		2,325	Adj. Bal.	675		=	<b>Liabilities</b>	+	<b>Owner's Equity (Expense)</b> <table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <thead> <tr> <th colspan="2">Supplies Expense</th> </tr> </thead> <tbody> <tr> <td>Aug 31</td> <td style="text-align: right;">2,325</td> </tr> </tbody> </table>	Supplies Expense		Aug 31	2,325
Supplies																				
Bal.	3,000																			
Aug 31		2,325																		
Adj. Bal.	675																			
Supplies Expense																				
Aug 31	2,325																			

by crediting it for the same amount.

## Help Students Go Beyond Memorization to True Understanding

Students often struggle to understand how concepts relate to one another. For most students, an introductory accounting course is their first exposure to both business transactions and the accounting system. While these concepts are already difficult to master individually, their combination and interdependency in the introductory accounting course often pose a challenge for students.

- **Mastery Problems.** New Mastery Problems enable you to assign problems and activities designed to test students' comprehension and mastery of difficult concepts.
- **Dynamic Exhibits.** To overcome this gap, the authors have created a series of interactive Dynamic Exhibits that allow students to change the variables in a scenario and see how a change ripples through the accounting system. Dynamic Exhibits allow students to see connections and relationships like never before.

## Insight into Your Class Performance

With CengageNOWv2's new Gradebook Analytics, you have an unprecedented insight into your students' performance. You may view class results not only on an aggregate assignment or item basis, but also on the basis of a variety of criteria. These include book objectives, Bloom's Taxonomy, AICPA standards, and more!

### Class Aggregate Report [?](#)

Sample Course

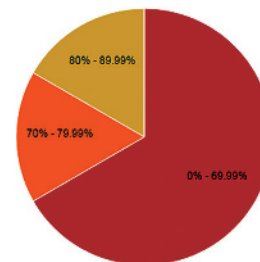
Choose your report:

Click a title to see more details. Click the pie to filter.

Assignment	Due Date	Class Average	# of Students Completed
Assignment 1	July 6, 2016, 12:00 AM	81%	11 / 13
Assignment 2	July 6, 2016, 12:00 AM	77%	11 / 13
Assignment 7	October 31, 2015, 12:00 AM	0%	1 / 13
Chapter 2 - ASP	September 11, 2017, 12:00 AM	0%	1 / 13
Exam	October 16, 2015, 12:00 AM	36%	1 / 13
test	October 29, 2017, 12:00 AM	25%	1 / 13

1 - 6 displayed, 6 in total

0% - 69.99% 70% - 79.99% 80% - 89.99% 90% - 100%



Other features of Gradebook Analytics include:

- Ability to drill into both aggregate class performance and individual student performance.
- Preview items and view score distribution on that item.
- View at a glance summary information for a particular class, assignment, or item.

## MindTap eReader

The MindTap eReader for Warren/Reeve/Duchac's *Corporate Financial Accounting* is the most robust digital reading experience available. Hallmark features include:

- Fully optimized for the iPad.
- Note taking, highlighting, and more.
- Embedded digital media.
- The MindTap eReader also features ReadSpeaker®, an online text-to-speech application that vocalizes, or “speech-enables,” online educational content. This feature is ideally suited for both instructors and learners who would like to listen to content instead of (or in addition to) reading it.



GENERAL LEDGER

## Cengage Learning General Ledger Software (CLGL)

CLGL exposes students to computerized accounting software without teaching the specifics of a certain software system—preparing students for *any* software program they might encounter in the real world.

- Available in CengageNOWv2, CLGL allows students to work through end-of-chapter assignments and practice sets in a format that emulates commercial general ledger software, but in a manner that is more forgiving of errors.
- Assignments are automatically graded online.
- Selected problems that can be solved using CLGL are designated by an icon in the textbook and are listed in the assignment preparation grid in the Instructor's Manual.

## Other CengageNOW Enhancements

- **Refreshed Design:** This refreshed look will help you and your students focus easily and quickly on what is important, while maintaining the same functionality that CengageNOW users know and love.
- **Integration with Popular Learning Management Systems:** Single login, deep linking, and grade return! (Check with your local Learning Consultant for more details.)



- **Upload Files Capability:** You can now upload files in CengageNOWv2 for student use—including videos, Excel files, Word files, and more.
- **Email Instructor Feature:** Students can now send their instructor a screenshot of the question they are working on directly through CengageNOWv2 and ask specific questions about where they are stuck.
- **Better Date Management:** When modifying assignment due dates for a whole course, the system will now automatically adjust due dates based on a new start date, making it easier to reuse a course from one term to the next and adjust for snow days.
- **Streamlined Assignment Creation Process:** A simplified and streamlined Assignment Creation process allows instructors to quickly set up and manage assignments from a single page.
- **New Report Options:** New reporting options allow you to get better reports on your students' progress.
- **New Student Registration Process:** When you create a course, a URL will be generated that will automatically take students right into the instructor's course without them having to enter the course key!

## New to This Edition

In this edition, we have reorganized the chapter sequence so that it follows the order of the balance sheet. Installation Notes (Chapter 10) and Bonds Payable (Chapter 11) now precede Corporations (Chapters 12). Additionally, in all chapters, the following improvements have been made:

- Added schema at beginning of each chapter linking material to the accounting cycle or the financial statements
- Updated dates and real company information for currency
- Added “Link to” for the opening company to interweave real world references throughout each chapter
- Added margin accounting equation impact for journal entries
- Refreshed end-of-chapter assignments with different numerical values and updated information
- Replaced the following:
  - “Financial Analysis and Interpretation” with “Analysis for Decision Making” followed by an exercise “Make a Decision”
  - “Business Connection” articles with “Why it Matters”
  - “Integrity, Objectivity, and Ethics in Business” articles with “Ethics: (Don’t) Do It”
  - “Example Exercises” with “Check Up Corner” boxes throughout chapter
  - “At A Glance” summaries with “Let’s Review” while retaining key points
  - “Illustrative Problems” with “Practice” which includes multiple-choice questions, exercises, problems, and related answers
  - “Practice Exercises” with “Basic Exercises”
  - “Cases & Projects” with “Take It Further”

## Chapter 1

- Added Characteristics of Financial Information section
- Updated sections on Assumptions and Principles
- Added “Why It Matters” article on Round-Tripping, which describes commercial substance
- Added “Check Up Corner” boxes on:
  - Business Transactions and the Accounting Equation
  - Financial Statements
- Replaced the “account” form of balance sheet with the “report” form of balance sheet so that one form is used throughout the text

## Chapter 2

- Refreshed exhibit Rules of Debit and Credit, Normal Balances of Accounts
- Added “Why It Matters” on Debits and Credits at the Bank and refreshed the Why It Matters on Computerized Accounting Systems
- Added “Check Up Corner” boxes on:
  - Balance Sheet Accounts
  - Preparing Journal Entries
  - Trial Balance
- When appropriate, account numbers are included in the trial balance

## Chapter 3

- Added Revenue and Expense Recognition section
- Added new Exhibits 1 and 2 that illustrate why adjustments are required for accruals and deferrals



- Reorganized/streamlined Accruals and Deferrals
- Added “Check Up Corner” boxes on:
  - Adjusting Entries for Accruals
  - Adjusting Entries for Deferrals
  - Depreciation
- Added “Why It Matters” on Sports Signing Bonus
- When given in end-of-chapter items, account numbers are included in the trial balance

## Chapter 4

- Added “Check Up Corner” boxes on:
  - Prepare Financial Statements from Adjusted Trial Balance
  - Closing Entries
- Added a “Why It Matters” on Temporary Accounts on Your Pay Stub
- Modified exhibit on Accounting Cycle so that it is consistent with the schema presented at the beginning of Chapters 1-4
- When appropriate, account numbers are included in the trial balance
- Added Appendix 2 Reversing Entries with exhibits on Accrued Wages, Wages Expense and Wages Payable after adjustment, and Wages Expense and Wages Payable after reversing entry

## Chapter 5

- Added “Why It Matters” on:
  - Comcast Versus Lowe’s
  - Apple’s Credit Terms
  - E-commerce Shopping Carts
- Changed account titles of “Cost of Merchandise Sold” to “Cost of Goods Sold” and “Merchandise Inventory” to “Inventory”
- Added “Check Up Corner” boxes on:
  - Purchases Transactions
  - Sales Transactions
  - Multiple-Step Income Statement
- Revised the illustration for NetSolutions, including the chart of accounts, to include customer returns and allowances
- Revised the discussion of customer returns and allowances so that the adjusting entries for returns and allowances are presented with the adjusting entry for inventory shrinkage near the end of the chapter
- Expanded and refreshed exhibits on Illustration of Inventory Transactions for Seller and Buyer, Multiple-Step Income Statement, Single-Step Income Statement, Retained Earnings Statement for Merchandising Business, and Balance Sheet for Merchandising Business
- Revised Appendix on the Periodic Inventory System to include customer returns and allowances

## Chapter 6

- Added “Why It Matters” on:
  - Pawn Stars and Specific Identification
  - Good Samaritan
- Added “Check Up Corner” boxes on:
  - Perpetual Inventory Costing
  - Periodic Inventory
  - Lower of Cost or Market
  - Effects of Inventory Errors

## Chapter 7

- Revised chapter title
- Added new exhibit on eBay’s Report of Compliance with Sarbanes-Oxley
- Added “Why It Matters” on:
  - Mobile Payments
  - Bank Error in Your Favor (or Maybe Not)
  - Apple’s Hedge Fund
- Updated “Why It Matters” on Employee Fraud
- Added “Check Up Corner” boxes on:
  - Internal Controls
  - Bank Reconciliation
- Revised the form of the bank reconciliation to be consistent with CengageNOWv2
- Added calculation of Days’ Cash on Hand in Analysis for Decision Making

## Chapter 8

- New chapter opener on Keurig Green Mountain, Inc.
- Added “Why It Matters” on:
  - Warning Signs
  - Failure to Collect
- Refreshed “Why It Matters” on Allowance Percentages Across Companies
- Added “Ethics: Don’t Do It” on extending credit to financially distressed companies
- Added “Check Up Corner” boxes on:
  - Percent of Sales Method
  - Analysis of Receivables Method
  - Notes Receivable

## Chapter 9

- Revised chapter title
- Changed “units-of-output method” to “units-of-activity method”
- Added new sections on Partial-Year Depreciation and Repair and Improvements
- Modified existing exhibits and added several new exhibits
- Added “Why It Matters” on:
  - Selling a Fixed Asset
  - Depreciation under IRS MACRS
  - Percent of Fixed Assets to Total Assets
  - Market Value versus Book Value

- Added “Check Up Corner” boxes on:
  - Fixed Assets
  - Natural Resources
  - Intangible Assets

## Chapter 10

- Revised chapter title
- Revamped and simplified discussion of Payroll and added new topic on Installment Notes (from Chapter 12 in previous edition)
- Added “Check Up Corner” boxes on:
  - Short-Term Note Payable
  - Payroll Entries
  - Installment Note
  - Contingent Liabilities
- Added “Why It Matters” on:
  - State Pension Obligations
  - Installment Credit
- Added new exhibits on Note Transactions: Borrower and Creditor and on Allocation of Periodic Payments

## Chapter 11

- Chapter 12 in the previous edition
- Moved topic of Installment Notes to Chapter 10
- New chapter opener on PepsiCo, Inc.
- Added a “Why It Matters” on Investor Bond Price Risk
- Added “Check Up Corner” boxes on:
  - Nature of Bonds Payable
  - Bond Issued at a Discount
  - Bond Issued at a Premium
- Updated “Ethics: Don’t Do It” article on The Ratings Game

## Chapter 12

- Chapter 11 in the previous edition
- Added “Why It Matters” on:
  - Red Tape and Starting a Business
  - You Have No Vote
  - Treasury Stock vs. Dividends
- Added “Check Up Corner” boxes on:
  - Classes of Stock
  - Dividends
  - Treasury Stock Transactions

- Refreshed exhibits on Stockholders’ Equity Section of a Balance Sheet and on Retained Earnings Statement

## Chapter 13

- Chapter 14 in the previous edition
- Added “Check Up Corner” boxes on:
  - Cash Flows from Operating Activities
  - Cash Flows from Investing Activities
  - Classify Cash Flows
- Added “Why It Matters” on:
  - Growing Pains
  - Twenty Years After
- Refreshed exhibits on Statement of Cash Flows – Indirect Method and Statement of Cash Flows – Direct Method
- Moved the discussion of the direct method to Appendix 2

## Chapter 14

- Chapter 15 in the previous edition
- Revamped sections on Analyzing Liquidity and Analyzing Solvency
- Name changes to several ratios:
  - “Number of Times Interest Charges Are Earned” to “Times Interest Earned”
  - “Ratio of Sales to Assets” to “Asset Turnover”
  - “Rate Earned on Total Assets” to “Return on Total Assets”
  - “Rate Earned on Stockholders’ Equity” to “Return on Stockholders’ Equity”
  - “Rate Earned on Common Stockholders’ Equity” to “Return on Common Stockholders’ Equity”
- Refreshed exhibit on Summary of Analytical Measures
- Added Appendix 2 on Fair Value and Comprehensive Income (from Chapter 13 in previous edition)
- Added “Check Up Corner” boxes on:
  - Horizontal and Vertical Analysis
  - Liquidity Analysis
  - Solvency Analysis
  - Profitability Analysis
- Added “Why It Matters” on:
  - Flying Off the Shelves
  - Economic Success
  - Investing for Yield

# Instructor Resources

## Solutions Manual

Author-written and carefully verified multiple times to ensure accuracy and consistency with the text, the Solutions Manual contains answers to the Discussion Questions, Basic Exercises, Exercises, Problems (Series A and Series B), Continuing Problems, Comprehensive Problems, Analysis for Decision Making, and Take It Further activities that appear in the text. These solutions help you easily plan, assign, and efficiently grade assignments.

## Test Bank

Test Bank content is delivered via Cengage Learning Testing, powered by Cognero® a flexible, online system that allows you to:

- Author, edit, and manage test bank content from multiple Cengage Learning solutions
- Create multiple test versions in an instant
- Deliver tests from your LMS, your classroom, or through CengageNOWv2

## Companion Website

This robust companion website provides immediate access to a rich array of teaching and learning resources—including the Instructor’s Manual, PowerPoint slides, and Excel Template Solutions. Easily download the instructor resources you need from the password-protected, instructor-only section of the site.

**Instructor’s Manual** Discover new ways to engage your students by utilizing the Instructor’s Manual ideas for class discussion, group learning activities, writing exercises, and Internet activities. Moreover, simplify class preparation by reviewing a brief summary of each chapter, a detailed chapter synopsis, teaching tips regarding a suggested approach to the material, questions students frequently ask in the classroom, lecture aids, and demonstration problems in the Instructor’s Manual. Transparency Masters and Handouts (with solutions) are also included. Quickly identify the assignments that best align with your course with the assignment preparation grid that includes information about learning objective coverage, difficulty level and Bloom’s taxonomy categorization,

time estimates, and accrediting standard alignment for business programs, AICPA, ACBSP, and IMA.

**PowerPoint Slides** Bring your lectures to life with slides designed to clarify difficult concepts for your students. The lecture PowerPoints include key terms and definitions, equations, examples, and exhibits from the textbook. Descriptions for all graphics in the PowerPoints are included to enhance PowerPoint usability for students with disabilities.

- **NEW** for this edition, a Condensed Instructor version of the lecture PowerPoints highlights key coverage in a shorter deck designed for essential coverage in class.
- Also **NEW** for this edition, a Worked Examples PowerPoint deck includes step-by-step walk-throughs of the most commonly assigned end-of-chapter problems.
- A separate PowerPoint deck that includes just the Exhibits from the textbook is ideal for instructors who create their own PowerPoint decks and just want to refresh them.

**Excel Template Solutions** Excel Templates are provided for selected long or complicated end-of-chapter exercises and problems to assist students as they set up and work the problems. Certain cells are coded to display a red asterisk when an incorrect answer is entered, which helps students stay on track. Selected problems that can be solved using these templates are designated by an icon in the textbook and are listed in the assignment preparation grid in the Instructor’s Manual. The Excel Template Solutions provide answers to these templates.



EXCEL TEMPLATE

**Practice Set Solutions** Establish a fundamental understanding of the accounting cycle for your students with Practice Sets, which require students to complete one month of transactions for a fictional company. Brief descriptions of each Practice Set are provided in the Table of Contents. The Practice Set Solutions provide answers to these practice sets.

# Student Resources

## Study Guide

Now available free in CengageNOWv2, the Study Guide allows students to easily assess what they know with a “Do You Know” checklist covering the key points in each chapter. To further test their comprehension, students can work through Practice Exercises, which include a “strategy” hint and solution so they can continue to practice applying key accounting concepts.

## Working Papers

Students will find the tools they need to help work through end-of-chapter assignments with the Working Papers. The preformatted templates provide a starting point by giving students a basic structure for problems and journal entries. Working Papers are available in a printed format as a bundle option.

## Practice Sets

For more in-depth application of accounting practices, instructors may choose from among six different Practice Sets for long-term assignments. Each Practice Set requires students to complete one month of transactions for a fictional company. Practice Sets can be solved manually or with the Cengage Learning General Ledger software.



## Website

Designed specifically for your students’ accounting needs, this website features student PowerPoint slides, Excel Templates, learning games, and flashcards.

- **PowerPoint Slides:** Students can easily take notes or review difficult concepts with the student version of this edition’s PowerPoint slides.
- **Excel Templates:** These Excel Templates help students stay on track. If students enter an incorrect answer in certain cells, a red asterisk will appear to let them know something is wrong. Problems that can be solved using these templates are designated by an icon.
- **Crossword Puzzles:** Students can focus on learning the key terms and definitions for each chapter in a different way by completing these crossword puzzles.
- **Flashcards:** Students can prepare with these flashcards, which cover the key terms and definitions they need to know for each chapter.



# Acknowledgements

The many enhancements to this edition of *Corporate Financial Accounting* are the direct result of one-on-one interviews, surveys, and focus groups with over 250 instructors at institutions across the country over the past year. We would like to take this opportunity to thank those who helped us better understand the challenges of the financial accounting course and provided valuable feedback on our content and digital assets.

## Instructors:

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This set is a merchandising business operated as a proprietorship. It includes business documents, and it can be solved manually or with the General Ledger software.

**Practice Set: Chic Events by Jada**

This set is a merchandising business operated as a proprietorship. It includes business documents, and it can be solved manually or with the General Ledger software.

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### Practice Set: My Place, House of Décor

This set is a service and merchandising business operated as a corporation. It includes narrative for six months of transactions, which are to be recorded in a general journal. The set can be solved manually or with the General Ledger software.

### Practice Set: JP's Tech Solutions

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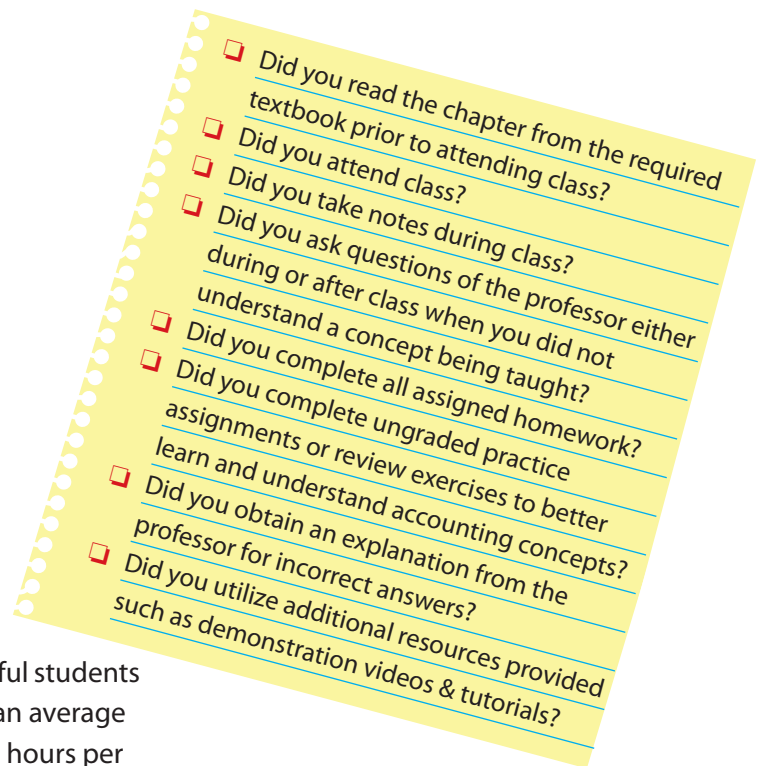
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# What Successful Students Are Saying

In a recent survey of students who took financial accounting courses, students stated that, in order to be successful in these courses, students should (in order of importance):

- Complete assigned homework
- Attend class and pay attention during the lecture
- Study
- Ask for help or get a tutor
- Complete ungraded practice assignments or review exercises



Successful students spent an average of four hours per week outside of class time studying, including completing assigned homework.

*You just need to put in the effort. If you work through the homework problems and show up to class, you will do well.*

—Brandy J. Gibson, Business Administration Major Ivy Tech Community College

*Do not put off homework – it is more important than you know – and when in need – ASK FOR HELP!!*

—Sally Cross, Accounting Major Ivy Tech Community College

*You need to attend every class and pay attention. Take good notes and do all the homework.*

—Melinda Lallier, Accounting Major Community College of Rhode Island

*Come to class every day – if you miss a class, you miss a lot of notes and example problems. Homework is vital and so is studying for tests – you need to learn the different formulas and equations.*

—Shannon Green, General Business Major Community College of Rhode Island

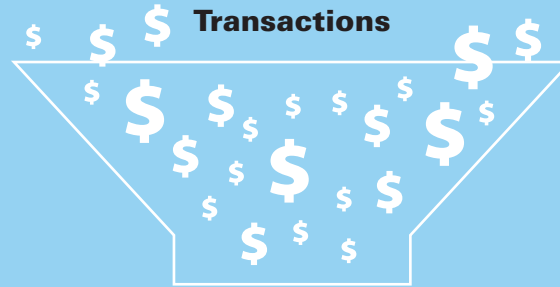
**Anyone can succeed at learning & understanding accounting concepts!  
How? Preparation, time management, & practice!**

**STUDY TIPS**

**Chapter 1**

# Introduction to Accounting and Business

**Chapter 1**



## Accounting System

### Accounting Equation

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$





## Twitter

**W**hen two teams pair up for a game of football, there is often a lot of noise. The band plays, the fans cheer, and fireworks light up the scoreboard. Obviously, the fans are committed and care about the outcome of the game. Just like fans at a football game, the owners of a business want their business to “win” against their competitors in the marketplace. While having your football team win can be a source of pride, winning in the marketplace goes beyond pride and has many tangible benefits. Companies that are winners are better able to serve customers, provide good jobs for employees, and make money for their owners.

**Twitter** is one of the most visible companies on the Internet. It provides a real-time information network where members can post messages, called Tweets, for free. Millions post Tweets every day throughout the world.

Do you think Twitter is a successful company? Does it make money? How would you know? Accounting helps to answer these questions.

This textbook introduces you to accounting, the language of business. Chapter 1 begins by discussing what a business is, how it operates, and the role that accounting plays.

# What's Covered

## Introduction to Accounting and Business

### Nature of Business

- Types (Obj. 1)
- Role of Accounting (Obj. 1)
- Ethics (Obj. 1)

### Nature of Accounting

- Types (Obj. 1)
- Opportunities (Obj. 1)
- Generally Accepted Accounting Principles (Obj. 2)

### Analyzing Business Transactions

- Accounting Equation (Obj. 3)
- Transactions (Obj. 4)

### Financial Statements

- Income Statement (Obj. 5)
- Retained Earnings Statement (Obj. 5)
- Balance Sheet (Obj. 5)
- Statement of Cash Flows (Obj. 5)

## Learning Objectives

- Obj. 1** Describe the nature of business and the role of accounting and ethics in business.
- Obj. 2** Describe generally accepted accounting principles, including the underlying assumptions and principles.
- Obj. 3** State the accounting equation and define each element of the equation.
- Obj. 4** Describe and illustrate how business transactions can be recorded in terms of the resulting change in the elements of the accounting equation.
- Obj. 5** Describe the financial statements of a corporation and explain how they interrelate.

## Analysis for Decision Making

Describe and illustrate the use of the ratio of liabilities to stockholders' equity in evaluating a company's financial condition.

### Objective 1

Describe the nature of business and the role of accounting and ethics in business.

## Nature of Business and Accounting

A **business**<sup>1</sup> is an organization in which basic resources (inputs), such as materials and labor, are assembled and processed to provide goods or services (outputs) to customers. Businesses come in all sizes, from a local coffee house to **Starbucks**, which sells over \$10 billion of coffee and related products each year.

The objective of most businesses is to earn a **profit**. Profit is the difference between the amounts received from customers for goods or services and the amounts paid for the inputs used to provide the goods or services. This text focuses on businesses operating to earn a profit. However, many of the same concepts and principles also apply to not-for-profit organizations such as hospitals, churches, and government agencies.

## Types of Businesses

Three types of businesses operating for profit include service, merchandising, and manufacturing businesses. Some examples of each type of business follow:

- **Service businesses** provide services rather than products to customers.
  - Delta Air Lines** (transportation services)
  - The Walt Disney Company** (entertainment services)
- **Merchandising businesses** sell products they purchase from other businesses to customers.
  - Walmart** (general merchandise)
  - Amazon.com** (Internet books, music, videos, ...)
- **Manufacturing businesses** change basic inputs into products that are sold to customers.
  - Ford Motor Co.** (cars, trucks, vans)
  - Dell Inc.** (personal computers)

Link to Twitter

**Twitter** is a service company that provides a platform for individuals to send text messages called tweets.

<sup>1</sup> A complete glossary of terms appears at the end of the text.

## Role of Accounting in Business

The role of accounting in business is to provide information for managers to use in operating the business. In addition, accounting provides information to other users in assessing the economic performance and condition of the business.

Thus, **accounting** can be defined as an information system that provides reports to users about the economic activities and condition of a business. You could think of accounting as the “language of business.” This is because accounting is the means by which businesses’ financial information is communicated to users.

*note:*

Accounting is an information system that provides reports to users about the economic activities and condition of a business.

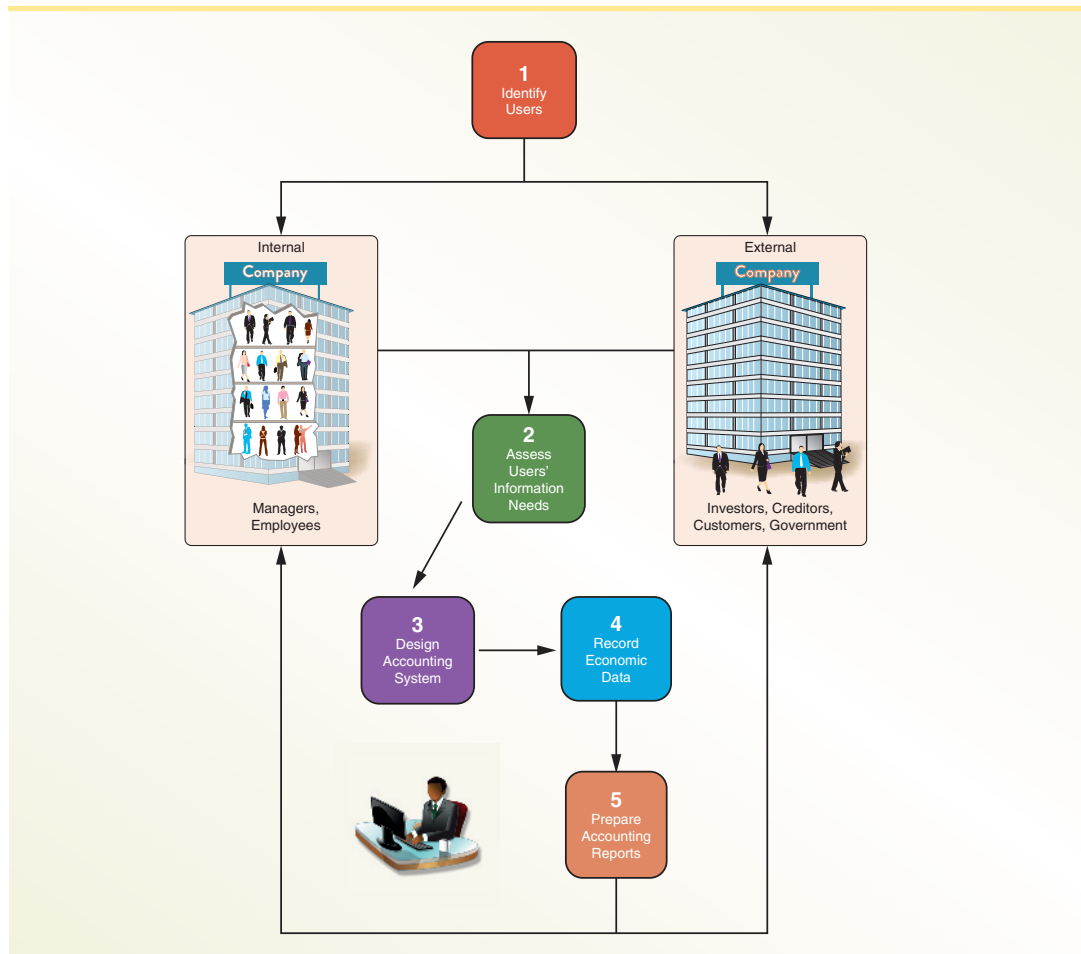
**Twitter** communicates to investors in an annual report that includes accounting information.

[Link to Twitter](#)

The process by which accounting provides information to users is as follows:

1. Identify users.
2. Assess users’ information needs.
3. Design the accounting information system to meet users’ needs.
4. Record economic data about business activities and events.
5. Prepare accounting reports for users.

As illustrated in Exhibit 1, users of accounting information can be divided into two groups: internal users and external users.



### Exhibit 1

Accounting as an Information System

**Managerial Accounting** Internal users of accounting information include managers and employees. These users are directly involved in managing and operating the business. The area of accounting that provides internal users with information is called **managerial accounting**, or **management accounting**.

The objective of managerial accounting is to provide relevant and timely information for managers' and employees' decision-making needs. Often, such information is sensitive and is not distributed outside the business. Examples of sensitive information might include information about customers, prices, and plans to expand the business. Managerial accountants employed by a business are employed in **private accounting**.

**Financial Accounting** External users of accounting information include investors, creditors, customers, and the government. These users are not directly involved in managing and operating the business. The area of accounting that provides external users with information is called **financial accounting**.

The objective of financial accounting is to provide relevant and timely information for the decision-making needs of users outside of the business. For example, financial reports on the operations and condition of the business are useful for banks and other creditors in deciding whether to lend money to the business. **General-purpose financial statements** are one type of financial accounting report that is distributed to external users. The term *general-purpose* refers to the wide range of decision-making needs that these reports are designed to serve. Later in this chapter, general-purpose financial statements are described and illustrated.

*Link to Twitter*

**Twitter** publishes general-purpose financial statements in its annual report to investors.



## Role of Ethics in Accounting and Business

The objective of accounting is to provide relevant, timely information for user decision making. Accountants must behave in an ethical manner so that the information they provide users will be trustworthy and, thus, useful for decision making. Managers and employees must also behave in an ethical manner in managing and operating a business. Otherwise, no one will be willing to invest in or loan money to the business.

**Ethics** are moral principles that guide the conduct of individuals. Unfortunately, business managers and accountants sometimes behave in an unethical manner. Many of the managers of the companies listed in Exhibit 2 engaged in accounting or business fraud. These ethical violations led to fines, firings, and lawsuits. In some cases, managers were criminally prosecuted, convicted, and sent to prison.

### Exhibit 2 Accounting and Business Frauds

Company	Nature of Accounting or Business Fraud	Result
<b>Computer Associates International, Inc.</b>	Fraudulently inflated its financial results.	CEO and senior executives indicted. Five executives pled guilty. \$225 million fine.
<b>Enron</b>	Fraudulently inflated its financial results.	Bankruptcy. Senior executives criminally convicted. More than \$60 billion in stock market losses.
<b>HealthSouth</b>	Overstated performance by \$4 billion in false entries.	Senior executives criminally convicted.
<b>Qwest Communications International, Inc.</b>	Improperly recognized \$3 billion in false receipts.	CEO and six other executives criminally convicted of "massive financial fraud." \$250 million SEC fine.
<b>Xerox Corporation</b>	Recognized \$3 billion in revenue prior to when it should have been recorded.	\$10 million fine to SEC. Six executives forced to pay \$22 million.

What went wrong for the managers and companies listed in Exhibit 2? The answer normally involved one or both of the following two factors:

- **Failure of Individual Character:** Ethical managers and accountants are honest and fair. However, managers and accountants often face pressures from supervisors to meet company



and investor expectations. In many of the cases in Exhibit 2, managers and accountants justified small ethical violations to avoid such pressures. However, these small violations became big violations as the company's financial problems became worse.

- **Culture of Greed and Ethical Indifference:** By their behavior and attitude, senior managers set the company culture. In most of the companies listed in Exhibit 2, the senior managers created a culture of greed and indifference to the truth.

As a result of the accounting and business frauds shown in Exhibit 2, Congress passed laws to monitor the behavior of accounting and business. For example, the **Sarbanes-Oxley Act (SOX)** was enacted. SOX established a new oversight body for the accounting profession called the **Public Company Accounting Oversight Board (PCAOB)**. In addition, SOX established standards for independence, corporate responsibility, and disclosure.

How does one behave ethically when faced with financial or other types of pressure? Guidelines for behaving ethically follow:<sup>2</sup>

1. Identify an ethical decision by using your personal ethical standards of honesty and fairness.
2. Identify the consequences of the decision and its effect on others.
3. Consider your obligations and responsibilities to those who will be affected by your decision.
4. Make a decision that is ethical and fair to those affected by it.

**Twitter's** "Code of Business Conduct and Ethics" can be found at <https://investor.twitterinc.com/corporate-governance.cfm>.

*Link to Twitter*

## Opportunities for Accountants

Numerous career opportunities are available for students majoring in accounting. Currently, the demand for accountants exceeds the number of new graduates entering the job market. This is partly due to the increased regulation of business caused by the accounting and business frauds shown in Exhibit 2. Also, more and more businesses have come to recognize the importance and value of accounting information.

As indicated earlier, accountants employed by a business are employed in private accounting. Private accountants have a variety of possible career options within a company. Some of these career options are shown in Exhibit 3 along with their starting salaries. As shown in Exhibit 3, several private accounting careers have certification options. Accountants who provide audit services, called *auditors*, verify the accuracy of financial records, accounts, and systems.

### Ethics: Don't Do It!

#### **Bernie Madoff**

Bernard L. "Bernie" Madoff was sentenced to 150 years in prison for defrauding thousands of investors in one of the biggest frauds in American history. Madoff's fraud started several decades earlier when he began a "Ponzi scheme" in his investment management firm, Bernard L. Madoff Investment Securities LLC.

In a Ponzi scheme, the investment manager uses funds received from new investors to pay a return to existing

investors, rather than basing investment returns on the fund's actual performance. As long as the investment manager is able to attract new investors, he or she will have new funds to pay existing investors and continue the fraud. While most Ponzi schemes collapse quickly when the investment manager runs out of new investors, Madoff's reputation, popularity, and personal contacts provided a steady stream of investors, which allowed the fraud to survive for decades.

Source: Bernie Madoff

<sup>2</sup> Many companies have ethical standards of conduct for managers and employees. In addition, the Institute of Management Accountants and the American Institute of Certified Public Accountants have professional codes of conduct, which can be obtained from their Web sites at [www.imanet.org](http://www.imanet.org) and [www.aicpa.org](http://www.aicpa.org), respectively.



**Exhibit 3** Accounting Career Paths and Salaries

Accounting Career Track	Description	Career Options	Annual Starting Salaries*	Certification
Private Accounting	Accountants employed by companies, government, and not-for-profit entities.	Bookkeeper	\$45,000	Certified Payroll Professional (CPP)
		Payroll clerk	\$41,000	
		General accountant	\$49,000	Certified Management Accountant (CMA) Certified Internal Auditor (CIA) Certified Information Systems Auditor (CISA)
		Budget analyst	\$52,000	
		Cost accountant	\$53,000	
		Internal auditor	\$60,000	
		Information technology auditor	\$68,000	
Public Accounting	Accountants employed individually or within a public accounting firm in audit, tax, or management advisory services.	Large firms (over \$250 million in revenue)	\$65,000	Certified Public Accountant (CPA)
		Mid-size firms (\$25–\$250 million in revenue)	\$58,000	Certified Public Accountant (CPA)
		Small firms (less than \$25 million in revenue)	\$54,000	Certified Public Accountant (CPA)

\*Average salaries rounded to the nearest thousand. Salaries may vary by size of company and region.

Source: Robert Half 2016 U.S. Salary Guide (Finance and Accounting), Robert Half International, Inc. ([www.roberthalf.com/workplace-research/salary-guides](http://www.roberthalf.com/workplace-research/salary-guides))

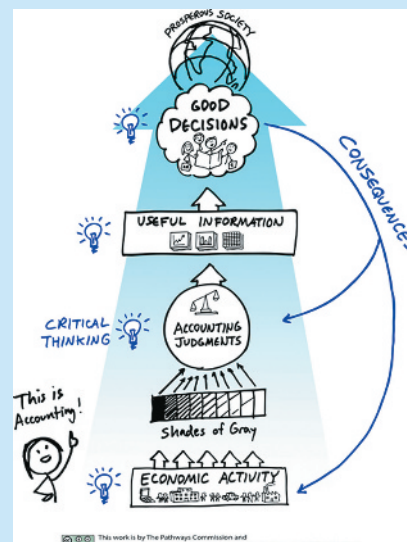
Accountants and their staff who provide services on a fee basis are said to be employed in **public accounting**. In public accounting, an accountant may practice as an individual or as a member of a public accounting firm. Public accountants who have met a state's education, experience, and examination requirements may become **Certified Public Accountants (CPAs)**. CPAs typically perform general accounting, audit, or tax services. As can be seen in Exhibit 3, CPAs have slightly better starting salaries than private accountants. Career statistics indicate, however, that these salary differences tend to disappear over time. The American Institute of Certified Public Accountants (AICPA) provides information and resources for students interested in accounting at [www.startheregoplaces.com](http://www.startheregoplaces.com).

Because all functions within a business use accounting information, experience in private or public accounting provides a solid foundation for a career. Many positions in industry and in government agencies are held by individuals with accounting backgrounds.

## Why It Matters

### Pathways Commission

The Pathways Commission recently issued its study titled *Charting a National Strategy for the Next Generation of Accountants*. The Commission was made up of diverse members and was jointly sponsored by the American Institute of Certified Public Accountants (AICPA) and the American Accounting Association (AAA). The Commission emphasized the importance of accounting for a prosperous society and good decision making. The Commission also emphasized that accountants must be critical thinkers who are comfortable addressing the shades of grey required by accounting judgments.



Source: *Charting a National Strategy for the Next Generation of Accountants*, The Pathways Commission, July 2012.

## Generally Accepted Accounting Principles (GAAP)

Financial information in the United States is based on **generally accepted accounting principles (GAAP)**. GAAP is a collection of *accounting standards, principles, and assumptions* that define how financial information will be reported.

- **Accounting standards** are the rules that determine the accounting for individual business transactions.
- **Accounting principles and assumptions** provide the framework upon which accounting standards are constructed.

Within the United States, the **Financial Accounting Standards Board (FASB)** has the primary responsibility for developing accounting standards. The FASB publishes *Statements of Financial Accounting Standards, Statements of Financial Accounting Concepts, and Interpretations*, which make up GAAP. The **Securities and Exchange Commission (SEC)**, an agency of the U.S. government, has authority over the accounting and financial disclosures for companies whose shares of ownership (stock) are traded and sold to the public. The SEC normally accepts the accounting standards set forth by the FASB. However, the SEC may issue *Staff Accounting Bulletins* on accounting matters that may not have been addressed by the FASB.

Outside the United States, most countries use accounting standards and principles adopted by the **International Accounting Standards Board (IASB)**. The IASB issues *International Financial Reporting Standards (IFRS)*. Differences currently exist between FASB and IASB accounting principles.

## Characteristics of Financial Information

The primary goal of financial accounting is to provide information that is useful for decision making. To be useful, financial reports must possess two important characteristics: *relevance* and *faithful representation*.

- **Relevant** information has the potential to impact decision making.
- **Faithful representation** means that the information accurately reflects an entity's economic activity or condition.

In addition to the preceding characteristics, GAAP has evolved based upon assumptions and principles.

## Assumptions

Financial accounting and generally accepted accounting principles are based upon the following assumptions:

- Monetary unit
- Time period
- Business entity
- Going concern

### Objective 2

Describe generally accepted accounting principles, including the underlying assumptions and principles.

## International Connection

### IFRS International Financial Reporting Standards (IFRS)

IFRS are considered to be more “principles-based” than U.S. GAAP, which is considered to be more “rules-based.” For

\*Differences between U.S. GAAP and IFRS are further discussed and illustrated in Appendix C.

example, U.S. GAAP consists of approximately 17,000 pages, which include numerous industry-specific accounting rules. In contrast, IFRS allow more judgment in deciding how business transactions are recorded. Many believe that the strong regulatory and litigation environment in the United States is the cause for the more rules-based GAAP approach. Regardless, IFRS and GAAP share many common principles.\*