WARREN / JONES 15

Corporate Financial Accounting

The Basics

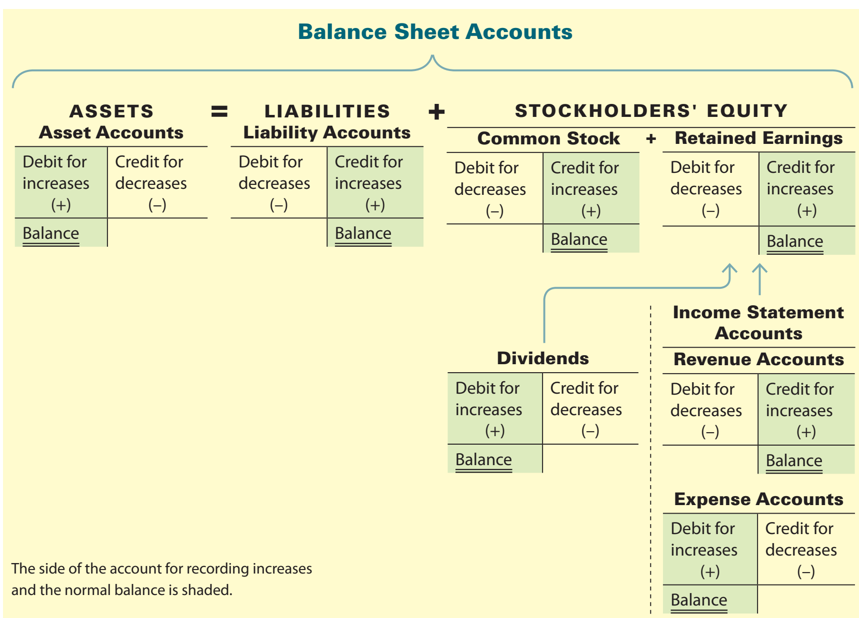
Accounting Equation:

Assets = Liabilities + Stockholders' Equity

T Account:

Account Title	
Left side	Right side
debit	credit

Rules of Debit and Credit, Normal Balances:



Analyzing and Journalizing Transactions

1. Carefully read the description of the transaction to determine whether an asset, liability, common stock, retained earnings, revenue, expense, or dividends account is affected.
2. For each account affected by the transaction, determine whether the account increases or decreases.
3. Determine whether each increase or decrease should be recorded as a debit or a credit, following the rules of debit and credit.
4. Record the transaction using a journal entry.
5. Periodically post journal entries to the accounts in the ledger.
6. Prepare an unadjusted trial balance at the end of the period.

Financial Statements:

- **Income statement:** A summary of the revenue and expenses for a specific period of time, such as a month or a year.
- **Statement of stockholders' equity:** A summary of the changes in stockholders' equity that have occurred during a specific period of time, such as a month or a year.
- **Balance sheet:** A list of the assets, liabilities, and stockholders' equity as of a specific date, usually at the close of the last day of a month or a year.
- **Statement of cash flows:** A summary of the cash receipts and cash payments for a specific period of time, such as a month or a year.

Accounting Cycle:

1. Transactions are analyzed and recorded in the journal.
2. Transactions are posted to the ledger.
3. An unadjusted trial balance is prepared.
4. Adjustment data are assembled and analyzed.
5. An optional end-of-period spreadsheet is prepared.
6. Adjusting entries are journalized and posted to the ledger.
7. An adjusted trial balance is prepared.
8. Financial statements are prepared.
9. Closing entries are journalized and posted to the ledger.
10. A post-closing trial balance is prepared.

Types of Adjusting Entries:

- Accrued revenue (accrued asset)
- Accrued expense (accrued liability)
- Unearned revenue (deferred revenue)
- Prepaid expense (deferred expense)
- Depreciation expense

Each entry will always affect both a balance sheet account and an income statement account.

Closing Entries:

1. Revenue and expense account balances are transferred to the retained earnings account.
2. The balance of the dividends account is transferred to the retained earnings account.

Shipping Terms:

	FOB Shipping Point	FOB Destination
Ownership (title) passes to buyer when merchandise is..................	delivered to freight carrier	delivered to buyer
Freight costs are paid by.........................	buyer	seller

Format for Bank Reconciliation:

Cash balance according to bank statement	$ XXX
Add: Deposits in transit	XXX
Deduct: Outstanding checks not paid by bank	(XXX)
Adjusted balance	$ XXX

Cash balance according to company's records	$ XXX
Add: Credit memos that have not been recorded (notes collected by bank)	XXX
Deduct: Debit memos that have not been recorded (NSF checks, service charges)	(XXX)
Adjusted balance	$ XXX

Inventory Costing Methods:

- First-in, First-out (FIFO)
- Last-in, First-out (LIFO)
- Average Cost

Interest Computations:

Interest = Face Amount (or Principal) × Rate × Time

Methods of Determining Depreciation:

Straight-Line: $\dfrac{\text{Cost} - \text{Estimated Residual Value}}{\text{Estimated Life}}$

Units-of-Activity: $\dfrac{\text{Cost} - \text{Estimated Residual Value}}{\text{Total Estimated Units of Activity}} \times \text{Units of Activity}$

Double-Declining-Balance: Rate* × Book Value at Beginning of Period

*Rate is commonly twice the straight-line rate (1 ÷ Estimated Life).

Adjustments to Net Income (Loss) Using the Indirect Method:

Net income (loss)	$ XXX	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation of fixed assets	XXX	
Amortization of intangible assets	XXX	
Losses on disposal of assets	XXX	
Gains on disposal of assets	(XXX)	
Changes in current operating assets and liabilities:		
Increases in noncash current operating assets	(XXX)	
Decreases in noncash current operating assets	XXX	
Increases in current operating liabilities	XXX	
Decreases in current operating liabilities	(XXX)	
Net cash flow from operating activities		$XXX

Subtract	Add
Increases in accounts receivable	Decreases in accounts receivable
Increases in inventory	Decreases in inventory
Increases in prepaid expenses	Decreases in prepaid expenses
Decreases in accounts payable	Increases in accounts payable
Decreases in accrued expenses payable	Increases in accrued expenses payable
Decreases in income taxes payable	Increases in income taxes payable

Summary of Analytical Measures

Liquidity Measures

Working Capital = Current Assets – Current Liabilities

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

$$\text{Accounts Receivable Turnover} = \frac{\text{Sales}}{\text{Average Accounts Receivable}}$$

$$\text{Numbers of Days' Sales in Receivables} = \frac{\text{Average Accounts Receivable}}{\text{Average Daily Sales}}$$

$$\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

$$\text{Number of Days' Sales in Inventory} = \frac{\text{Average Inventory}}{\text{Average Daily Cost of Goods Sold}}$$

Solvency Measures

$$\text{Ratio of Fixed Assets to Long-Term Liabilities} = \frac{\text{Fixed Assets (net)}}{\text{Long-Term Liabilities}}$$

$$\text{Ratio of Liabilities to Stockholders' Equity} = \frac{\text{Total Liabilities}}{\text{Total Stockholders' Equity}}$$

$$\text{Times Interest Earned} = \frac{\text{Income Before Income Tax} + \text{Interest Expense}}{\text{Interest Expense}}$$

Profitability Measures

$$\text{Asset Turnover} = \frac{\text{Sales}}{\text{Average Total Assets (excluding long-term investments)}}$$

$$\text{Return on Total Assets} = \frac{\text{Net Income} + \text{Interest Expense}}{\text{Average Total Assets}}$$

$$\text{Return on Stockholders' Equity} = \frac{\text{Net Income}}{\text{Average Total Stockholders' Equity}}$$

$$\text{Return on Common Stockholders' Equity} = \frac{\text{Net Income} - \text{Preferred Dividends}}{\text{Average Common Stockholders' Equity}}$$

$$\text{Earnings per Share (EPS)} = \frac{\text{Net Income} - \text{Preferred Dividends}}{\text{Shares of Common Stock Outstanding}}$$

$$\text{Price-Earnings (P/E) Ratio} = \frac{\text{Market Price per Share of Common Stock}}{\text{Earnings per Share on Common Stock}}$$

$$\text{Dividends per Share} = \frac{\text{Dividends on Common Stock}}{\text{Shares of Common Stock Outstanding}}$$

$$\text{Dividend Yield} = \frac{\text{Dividends per Share of Common Stock}}{\text{Market Price per Share of Common Stock}}$$

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Corporate Financial Accounting 15e

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Preface

Roadmap for Success

Warren/Jones *Corporate Financial Accounting*, *15e*, provides a sound pedagogy for giving students a solid foundation in business and accounting. Warren/Jones covers the fundamentals AND motivates students to learn by showing how accounting is important to businesses.

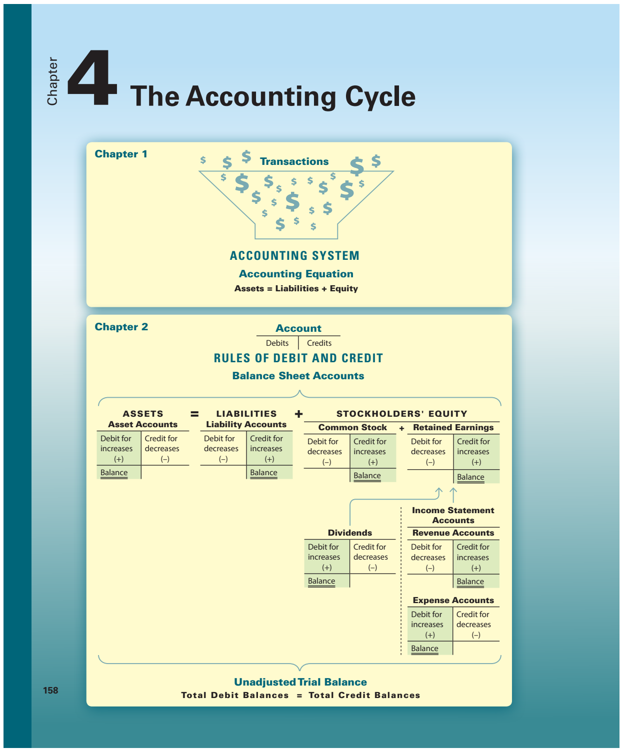
Warren/Jones is successful because it reaches students with a combination of new and tried-and-tested pedagogy.

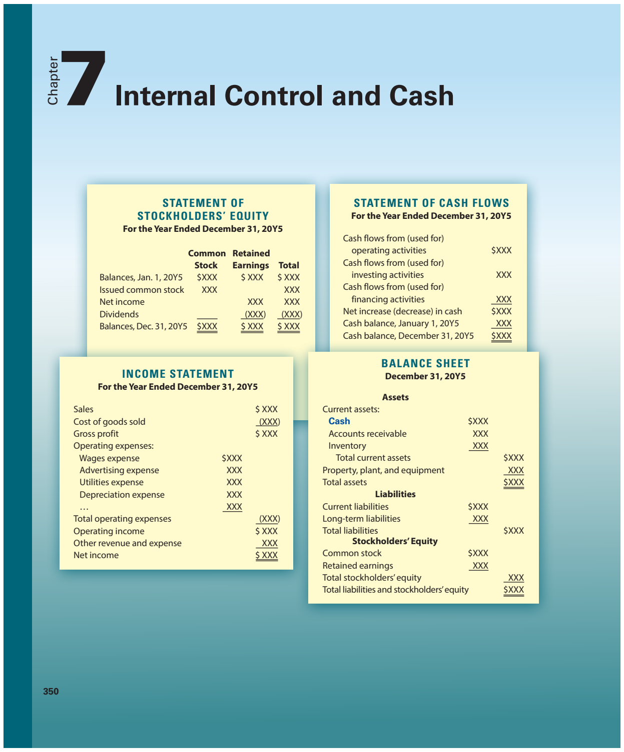
This revision includes a range of new and existing features that help Warren/Jones provide students with the context to see how accounting is valuable to business. These include:

- New! Make a Decision section
- New! Pathways Challenge

Warren/Jones 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
- Updated schema
- 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 illustrates 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.





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

Best Buy

Assume that in September you purchased a Sony HDTV from **Best Buy (BBY)**. At the same time, you purchased a Denon surround sound system for $599.99. You liked your surround sound so well that in November you purchased an identical Denon system on sale for $549.99 for your bedroom TV. Over the holidays, you moved to a new apartment and in the process of unpacking discovered that one of the Denon surround sound systems was missing. Luckily, your renters or homeowners insurance policy will cover the theft; but the insurance company needs to know the cost of the system that was stolen.

The Denon systems were identical. However, to respond to the insurance company, you will need to identify which system was stolen. Was it the first system, which cost $599.99, or was it the second system, which cost $549.99? Whichever assumption you make may determine the amount that you receive from the insurance company.

Businesses such as Best Buy make similar assumptions when identical merchandise is purchased at different costs. For example, Best Buy may have purchased thousands of Denon surround sound systems over the past year at different costs. At the end of a period, some of the Denon systems will still be in inventory, and some will have been sold. But which costs relate to the sold systems, and which costs relate to the Denon systems still in inventory? Best Buy's assumption about inventory costs can involve large dollar amounts and, thus, can have a significant impact on the financial statements. For example, Best Buy reported $5,051 million of inventory and net income of $897 million for a recent year.

This chapter discusses such issues as how to determine the cost of merchandise in inventory and the cost of goods sold. However, this chapter begins by discussing the importance of control over inventory.

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Best Buy uses scanners to screen customers as they leave the store for merchandise that has not been purchased. In addition, Best Buy stations greeters at the store's entrance to keep customers from bringing in bags that can be used to shoplift merchandise.

Link to Best Buy

- **New! Pathways Challenge** encourages students' interest in accounting and emphasizes the critical thinking aspect of accounting. A suggested answer to the Pathways Challenge is provided at the end of the chapter.

Pathways Challenge

This is Accounting!

Economic Activity

Verizon Communications Inc. (VZ) is the largest wireless service provider in the United States with over 114 million retail subscribers. To deliver its products and services, Verizon must have access to spectrum—the radio frequencies that carry sound, data, and video to wireless devices. However, spectrum is a limited resource that the Federal Communications Commission (FCC) licenses to businesses for a period of 10 years, subject to renewal. In a recent year, Verizon acquired almost $10 billion in wireless licenses.

Critical Thinking/Judgment

How should Verizon account for its acquisition of wireless licenses?
What is the useful life of a wireless license?
Should Verizon expense (amortize) the cost of its wireless licenses?

Suggested answer at end of chapter.

Pathways Challenge

This is Accounting!

Information/Consequences

Because a wireless license does not exist physically, **Verizon**'s **(VZ)** wireless licenses are intangible assets. All of the costs of acquiring a wireless license should be recorded as an asset. In a recent year, Verizon reported almost $87 billion of wireless licenses, representing 35% of its total assets.

Even though the FCC license is granted for a 10-year period, Verizon considers this license to have an indefinite useful life. This is because the license is subject to renewal at a low cost and, historically, the FCC has renewed Verizon's licenses.

Verizon does not expense (amortize) the cost of its wireless licenses. Instead, the licenses are reviewed for any impaired value.

Suggested Answer

- Located in each chapter, **Why It Matters** shows students how accounting is important to businesses with which they are familiar. A Concept Clip icon indicates which Why It Matters features have an accompanying concept clip video in CNOWv2.

CONCEPT CLIP

Why It Matters

CONCEPT CLIP

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
McDonald's Corporation (MCD)	Food Retail	69%
Target Corporation (TGT)	Merchandise Retail	63%
Delta Air Lines, Inc. (DAL)	Transportation	48%
Verizon Communications Inc. (VZ)	Communications	35%
The Walt Disney Company (DIS)	Entertainment	30%
Facebook, Inc. (FB)	Social Media	13%
Microsoft Corporation (MSFT)	Software	9%

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 or 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 funds to purchase. Managers must acquire funding internally or by other sources to finance the purchase of fixed assets.

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

20Y8				
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
+   +

- **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.

Journal

A. Journalize and insert the posting references for the October 3, 2018, transaction on page 91 of Regal Company's two-column journal.

PAGE 91

	JOURNAL					ACCOUNTING EQUATION		
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	ASSETS	LIABILITIES	EQUITY
1	Oct. 3	Supplies		3,600.00		↑		
2		Accounts Payable			3,600.00		↑	

- 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 9-2 Selling Fixed Assets

On the first day of the year, Firefall Company purchased equipment at a cost of $340,000. The equipment was expected to have a useful life of four years, a residual value of $20,000, and is depreciated at a straight-line rate of 25%. Firefall sold the equipment at the beginning of the fourth year when the balance in the accumulated depreciation account was $240,000. Journalize the entry to record the sale if the equipment was sold for:

a. $95,000

b. $105,000

Solution:

a. Equipment sold for $95,000:

Cash	95,000	
Accumulated Depreciation—Equipment	240,000	
Loss on Sale of Equipment	5,000	
Equipment		340,000

Selling Price – Book Value =
$95,000 – $100,000

Accumulated
Depreciation at
the End of Year 3

b. Equipment sold for $105,000:

Cash	105,000	
Accumulated Depreciation—Equipment	240,000	
Equipment		340,000
Gain on Sale of Equipment		5,000

Selling Price – Book Value =
$105,000 – $100,000

Check Up Corner

- **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

Fixed Asset Turnover Ratio

Objective 7
Describe and illustrate the fixed asset turnover ratio to assess the efficiency of a company's use of its fixed assets.

The **fixed asset turnover ratio** measures the number of sales dollars earned per dollar of fixed assets. The higher the ratio, the more efficiently a company is using its fixed assets in generating sales. The ratio is computed as follows:

$$\text{Fixed Asset Turnover Ratio} = \frac{\text{Sales}}{\text{Average Book Value of Fixed Assets}}$$

To illustrate, the following data (in millions) were taken from a recent financial statement of **McDonald's Corporation (MCD)**:

Sales	$24,621.9
Fixed assets (net):	
Beginning of year	21,257.6
End of year	23,117.6

McDonald's fixed asset turnover ratio for the year is computed as follows (rounded to one decimal place):

$$\text{Fixed Asset Turnover Ratio} = \frac{\text{Sales}}{\text{Average Book Value of Fixed Assets}}$$
$$= \frac{\$24{,}621.9}{(\$21{,}257.6 + \$23{,}117.6) \div 2}$$
$$= \frac{\$24{,}621.9}{\$22{,}187.6} = 1.1$$

Is 1.1 efficient? To answer this question, McDonald's fixed asset turnover ratio can be compared to other quick-service restaurant companies, as shown in Exhibit 14. **Yum! Brands (YUM)** operates KFC, Pizza Hut, and Taco Bell quick-service restaurants. The other restaurants are likely familiar by name.

- **Make a Decision** in the end-of-chapter material gives students a chance to analyze and compare real companies.

Make a Decision
Fixed Asset Turnover Ratio

REAL WORLD

MAD 9-1 Analyze and compare Amazon.com to Netflix **Obj. 7**

Amazon.com, Inc. (AMZN) is the world's leading Internet retailer of merchandise and media. Amazon also designs and sells electronic products, such as e-readers. **Netflix, Inc. (NFLX)** is one of the world's leading Internet television networks. Both companies compete in the digital media and streaming space. However, Netflix is more narrowly focused in the digital streaming business than is Amazon.

Sales and average book value of fixed assets information (in millions) are provided for Amazon and Netflix for a recent year as follows:

	Amazon.com	Netflix
Sales	$135,987	$8,830
Average book value of fixed assets	25,476	212

a. Compute the fixed asset turnover ratio for each company. Round to one decimal place.
b. Which company is more efficient in generating sales from fixed assets?
c. Interpret your results.

REAL WORLD

MAD 9-2 Analyze and compare Alaska Air, Delta Air Lines, and Southwest Airlines **Obj. 7**

Alaska Air Group (ALK), **Delta Air Lines (DAL)**, and **Southwest Airlines (LUV)** reported the following financial information (in millions) in a recent year:

	Alaska Air Group	Delta Air Lines	Southwest Airlines
Sales	$5,931	$39,639	$20,425
Average book value of fixed assets	5,234	23,707	16,323

a. Determine the fixed asset turnover ratio for each airline. Round to one decimal place.
b. Based on the fixed asset turnover ratio, which airline appears to be the most efficient in the use of its fixed assets?
c. The most important fixed asset to an airline is the aircraft. Given this, what factors might influence the efficient use of fixed assets for an airline?

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

CENGAGENOWv2

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, such as algorithmic activities, a test bank, course management tools, reporting and assessment options, and much more.

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

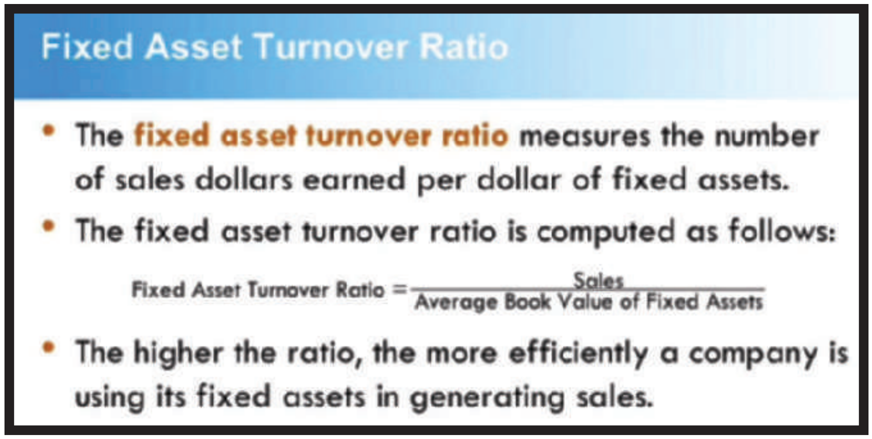
Students are often surprised by the amount of time they need to spend outside of class working through homework assignments in order to succeed. The CengageNOWv2 Start-Up Center will help students identify what they need to do and where they need to focus in order to be successful with a variety of new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

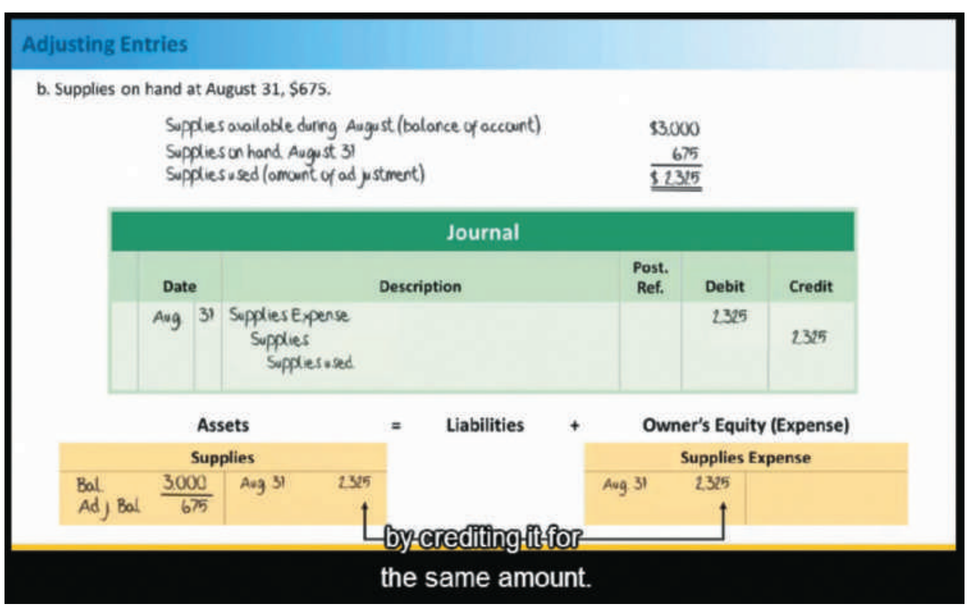
- **Video: Tell Me More.** Short Tell Me More lecture activities explain the core concepts of the chapter through an engaging auditory and visual presentation. Available either on a standalone basis or as an assignment, they are ideal for all class formats—flipped model, online, hybrid, or face-to-face.



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, Show Me How problem demonstration videos provide a step-by-step model of a similar problem. Embedded tips help students avoid common mistakes and pitfalls.



SHOW ME HOW

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.** Mastery Problems enable you to assign problems and activities designed to test students' comprehension and mastery of difficult concepts.

MindTap eReader

The MindTap eReader for Warren/Jones' *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.

New to This Edition

In all chapters, the following improvements have been made:

- Chapter schemas have been revised throughout.
- New list of references to the opening company at the beginning of the chapter allows students to easily locate the ties to the opening company throughout the chapter.
- New learning objective for Analysis for Decision Making.
- Stock ticker symbol has been inserted for all real-world (publicly listed) companies. This allows students to easily use financial websites to locate real company data.
- Years are now identified as 20Y1, 20Y2, …., 20Y9.
- New Pathways Challenge feature added, consistent with the work of the Pathways Commission. This feature emphasizes the critical thinking aspect of accounting. A Suggested Answer to the Pathways Challenge is provided at the end of the chapter.
- New Make a Decision section at the end of the Analysis for Decision Making allows students and instructors to easily locate the real-world company end-of-chapter materials related to Analysis for Decision Making. Also, the continuing company analysis is identified and referenced in this Make a Decision section.
- New exercise based on Analysis for Decision Making has been added to the Let's Review section of the chapter.
- New Basic Exercise based on Analysis for Decision Making has been added to the chapter.
- New items have been added to the Take It Further section of the chapter.

Chapter 1

- Enhancing characteristics added to discussion of GAAP.
- Discussion of fiscal year added to time period discussion of GAAP (moved from Chapter 6). This is consistent with use of fiscal years throughout Chapters 1–4 and with the fact that many publicly traded companies use fiscal years not ending in December 31.
- The statement of stockholders' equity replaces the retained earnings statement. This is consistent with the financial reporting of publicly held companies who report a statement of stockholders' equity rather than a retained earnings statement.
- Exhibit 8 revised to show the interrelationships of the statement of stockholders' equity with the income statement and balance sheet.

Chapter 2

- Revised the discussion of correcting entries and inserted new exhibit to better enhance student understanding.

Chapter 3

- Exhibit 1 (Accruals) has been revised to make it consistent with Exhibit 2 (Deferrals).
- The chapter has been changed so that accruals are discussed and illustrated first, followed by deferrals. Accruals are the simplest adjustment (no entry has been made). Thus, the chapter discussion now goes from simple to complex, which facilitates student understanding of this complex topic.

Chapter 4

- New learning objectives for Appendices 1 and 2.
- The statement of stockholders' equity replaces the retained earnings statement. This is consistent with the financial reporting of publicly held companies that report a statement of stockholders' equity rather than a retained earnings statement.
- Exhibit 1 revised to show the interrelationships of the statement of stockholders' equity with the income statement and balance sheet.
- Simplified and updated the closing process so that *two* rather than *four* closing entries are required. Doing so eliminates the temporary (clearing) account Income Summary, which students have difficulty understanding.
- Exhibit 8 (Accounting Cycle) revised and made more readable.

Chapter 5

- Chapter has been retitled as "Accounting for Retail Businesses." Using *Retail* in the title rather than *Merchandising* is more current terminology that students can identify with.
- Schema revised to only focus on the financial statements and the key accounts that will be discussed within the chapter.
- New learning objective and separate discussion for the adjusting process of a retail business.
- New learning objective and Appendix "Gross Method of Recording Sales Discounts." This gives instructors flexibility as to whether to cover the net or gross methods of accounting for sales discounts.
- Chart of Accounts for Retail Businesses (Exhibit 2) has been moved earlier in the chapter so that students can focus on the new accounts specific to retail businesses.
- Customer refunds, allowances, and returns discussion has been simplified to progress from simple to complex, as summarized in Exhibit 7.
- Closing process for a retail business has been revised to use a two-entry closing process.
- The statement of stockholders' equity replaces the retained earnings statement. This is consistent with the financial reporting of publicly held companies that report a statement of stockholders' equity rather than a retained earnings statement.

Chapter 6

- New Check Up Corner on weighted average inventory method has been added.
- New exhibit on weighted average flow of costs has been added.
- Weighted average illustration has been added to Check Up Corner 6-3.
- Added an illustration of the lower of cost or net realizable for inventory applied by different *classes* of inventory (Exhibit 10).

Chapter 7

- Presentation of bank reconciliation has been reformatted.

Chapter 9

- New Check Up Corner on selling fixed assets was added.
- Lease discussion was modified to reflect the latest accounting standard.

Chapter 10

- Simplified Exhibit 1 by removing cash/sales discounts.

Chapter 11

- Present value formulas have been added to Appendix 1, "Present Value Concepts and Pricing Bonds Payable."

Chapter 12

- Added brief discussion of different classes of common stock (Classes A, B, and C).

Appendix D Investments

- The investments appendix has been updated to be consistent with *Financial Instruments, Subtopic 825-10, FASB Accounting Standards Update*, Financial Accounting Standards Board, Norwalk, CT, January 2016.

Acknowledgements

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Dr. Carl S. Warren is Professor Emeritus of Accounting at the University of Georgia, Athens. Dr. Warren has taught classes at the University of Georgia, University of Iowa, Michigan State University, and University of Chicago. He has focused his teaching efforts on principles of accounting and auditing. Dr. Warren received his PhD from Michigan State University and his BBA and MA from the University of Iowa. During his career, Dr. Warren published numerous articles in professional journals, including *The Accounting Review, Journal of Accounting Research, Journal of Accountancy, The CPA Journal*, and *Auditing: A Journal of Practice and Theory*. Dr. Warren has served on numerous committees of the American Accounting Association, the American Institute of Certified Public Accountants, and the Institute of Internal Auditors. He has consulted with numerous companies and public accounting firms. His outside interests include handball, golfing, skiing, backpacking, motorcycling, and fly-fishing. He also enjoys interacting with his five grandchildren, Bella and Mila (twins), Jeremy, and Brooke and Robbie (twins).

Jefferson P. Jones

Dr. Jefferson P. Jones is an Associate Professor of Accounting in the School of Accountancy at Auburn University where he teaches financial accounting and applied financial research courses. He received his Bachelor's in Accounting and Master of Accountancy degrees from Auburn University and his PhD from Florida State University. Dr. Jones has received numerous teaching awards, including the Auburn University Beta Alpha Psi Outstanding Teaching Award (eight times); the Auburn University Outstanding Master of Accountancy Professor Teaching Award (five times); the Auburn University Outstanding Distance Master of Accountancy Teaching Award (three times); and the Auburn University College of Business McCartney Teaching Award. In addition, he has made numerous presentations around the country on research and pedagogical issues. Dr. Jones has public accounting experience as an auditor with Deloitte and Touche, holds a CPA certificate in the state of Alabama (inactive), and is a member of the American Accounting Association, the American Institute of Certified Public Accountants (AICPA), and the Alabama Society of CPAs (ASCPA). His research interests focus on financial accounting, specifically investigating the quality of reported accounting information, and accounting education. He has published articles in numerous journals, including *Advances in Accounting*, *Review of Quantitative Finance and Accounting*, *Issues in Accounting Education*, *International Journal of Forecasting*, and *The CPA Journal*. When not at work, Dr. Jones enjoys playing golf and watching college football.

Brief Contents

Contents

What Successful Students Are Saying

In a recent survey, students who had taken financial accounting courses listed the following actions as important steps to success in these courses:

- 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

- ❑ Did you read the chapter from the required textbook prior to attending class?
- ❑ Did you attend class?
- ❑ Did you take notes during class?
- ❑ Did you ask questions of the professor either during or after class when you did not understand a concept being taught?
- ❑ Did you complete all assigned homework?
- ❑ Did you complete ungraded practice assignments or review exercises to better learn and understand accounting concepts?
- ❑ Did you obtain an explanation from the professor for incorrect answers?
- ❑ Did you utilize additional resources provided such as demonstration videos & tutorials?

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!

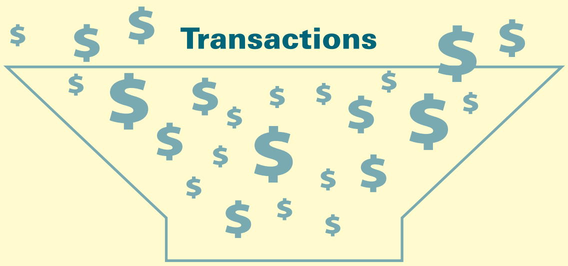
STUDY TIPS

Corporate Financial Accounting 15e

Chapter

1 Introduction to Accounting and Business

Chapter 1



ACCOUNTING SYSTEM

Accounting Equation

Assets = Liabilities + Equity

Chapter 2

ANALYZING TRANSACTIONS

Chapter 3

THE ADJUSTING PROCESS

Chapter 4

THE ACCOUNTING CYCLE

Twitter, Inc.

When 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, Inc. (TWTR) 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.

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Link to Twitter . . . . Pages 4, 5, 6, 7, 10, 11, 13, 21, 23

Analysis for Decision Making . . . . Page 26

What's Covered

Introduction to Accounting and Business

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

Nature of Accounting
- Managerial and Financial Accounting (Obj. 1)
- Career Opportunities (Obj. 1)

Analyzing Business Transactions
- Generally Accepted Accounting Principles (Obj. 2)
- Accounting Equation (Obj. 3)
- Transactions (Obj. 4)

Financial Statements
- Income Statement (Obj. 5)
- Statement of Stockholders' Equity (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

Obj. 6 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**[1] 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 (SBUX)**, which sells over $15 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, retail, and manufacturing businesses. Some examples of each type of business follow:

- **Service businesses** provide services rather than products to customers.
  - **Delta Air Lines (DAL)** (transportation services)
  - **The Walt Disney Company (DIS)** (entertainment services)
- **Retail businesses** sell products they purchase from other businesses to customers.
  - **Wal-Mart Stores, Inc. (WMT)** (general merchandise)
  - **Amazon.com (AMZN)** (Internet books, music, videos, ...)
- **Manufacturing businesses** change basic inputs into products that are sold to customers.
  - **Ford Motor Company (F)** (cars, trucks, vans)
  - **Merck & Co., Inc. (MRK)** (pharmaceutical drugs)

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

[1] 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.

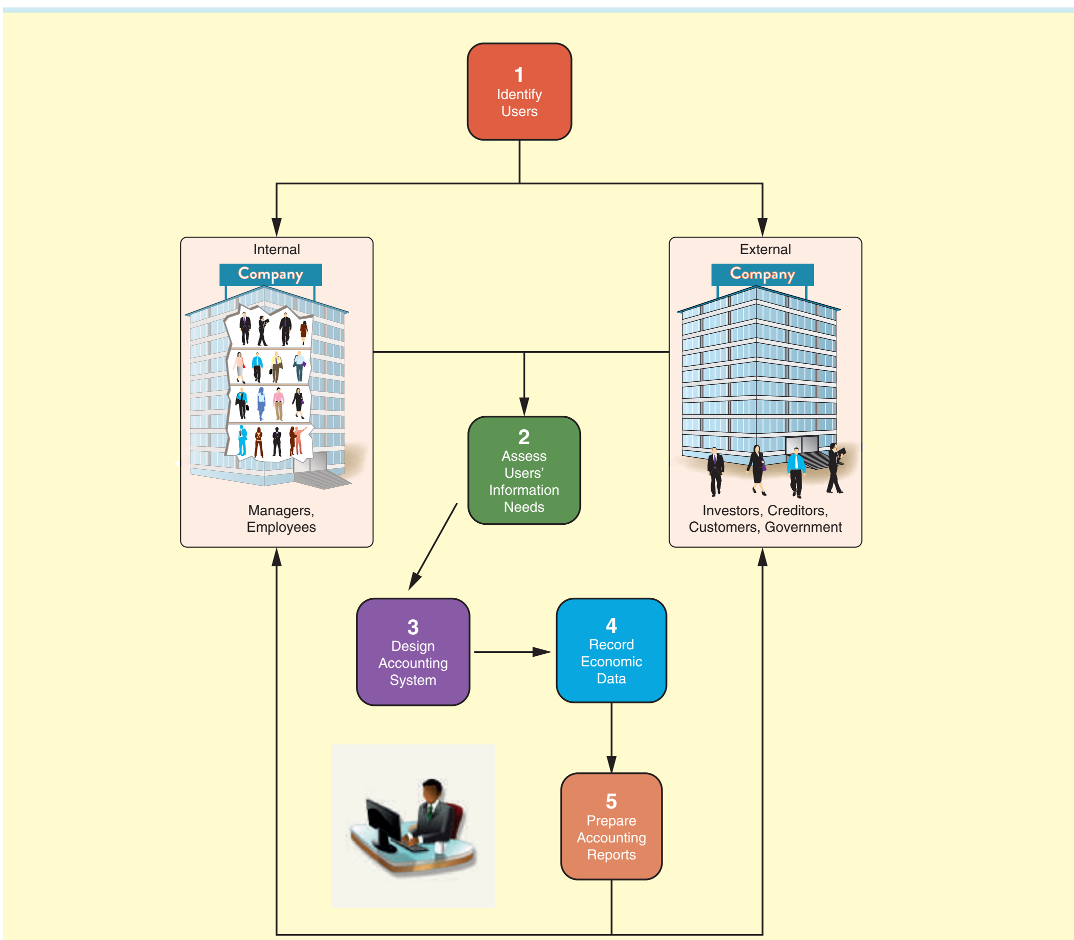
Link to Twitter

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

ETHICS

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
Computer Associates International, Inc.	Fraudulently inflated its financial results.	CEO and senior executives indicted. Five executives pled guilty. $225 million fine.
Enron	Fraudulently inflated its financial results.	Bankruptcy. Senior executives criminally convicted. More than $60 billion in stock market losses.
HealthSouth	Overstated performance by $4 billion in false entries.	Senior executives criminally convicted.
Qwest Communications International, Inc.	Improperly recognized $3 billion in false receipts.	CEO and six other executives criminally convicted of "massive financial fraud." $250 million SEC fine.
Xerox Corporation	Recognized $3 billion in sales 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:[2]

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 returns on the investments' 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

[2] 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 and 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	$40,000	
		Payroll clerk	$40,000	Certified Payroll Professional (CPP)
		General accountant	$51,000	
		Budget analyst	$53,000	
		Cost accountant	$55,000	Certified Management Accountant (CMA)
		Internal auditor	$62,000	Certified Internal Auditor (CIA)
		Information technology auditor	$71,000	Certified Information Systems Auditor (CISA)
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)	$68,000	Certified Public Accountant (CPA)
		Mid-size firms ($25–$250 million in revenue)	$61,000	Certified Public Accountant (CPA)
		Small firms (less than $25 million in revenue)	$56,000	Certified Public Accountant (CPA)

*Average salaries rounded to the nearest thousand. Salaries may vary by size of company and region.
Source: Robert Half *2017 U.S. Salary Guide (Finance and Accounting)*, Robert Half International, Inc. (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.

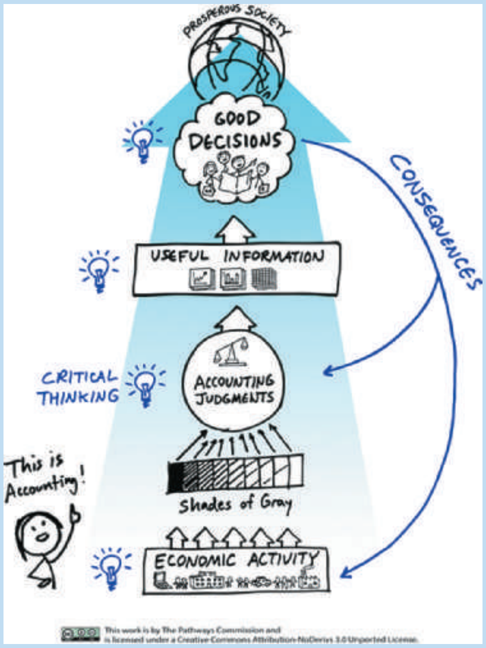
Because all functions within a business use accounting information, experience in private or public accounting provides a solid foundation for a career. Many positions in industry and in government agencies are held by individuals with accounting backgrounds.

Why It Matters

CONCEPT CLIP

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 gray 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)

Objective 2
Describe generally accepted accounting principles, including the underlying assumptions and principles.

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 maintains an electronic database, called the **Accounting Standards Codification**, that contains all the accounting standards that make up GAAP. Changes in the FASB Codification are made using **Accounting Standards Updates**.

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). Major differences between FASB and IASB accounting principles are identified throughout the chapters of this text and in Appendix C.

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.

The characteristics of relevant and faithful representation are enhanced by the following:

- **Comparability** allows users to identify similarities and differences among reported items.
- **Verifiability** allows users to agree on the meaning of reported items.
- **Timeliness** requires distribution of financial reports in time to influence a user's decision.
- **Understandability** requires clear and concise financial reports that facilitate user interpretation and analysis.

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 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.*

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