

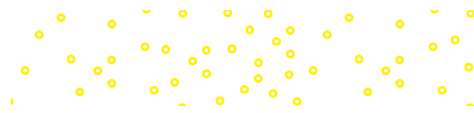
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Seventh Edition

FUNDAMENTALS OF
FINANCIAL
ACCOUNTING

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Fundamentals of FINANCIAL ACCOUNTING

Seventh Edition

FRED PHILLIPS

University of Saskatchewan

SHANA CLOR-PROELL

Texas Christian University

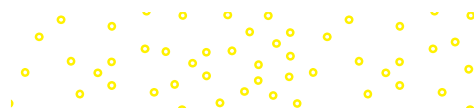
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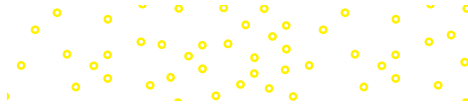
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FUNDAMENTALS OF FINANCIAL ACCOUNTING

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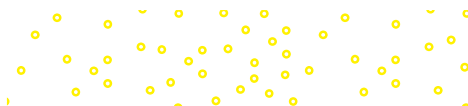
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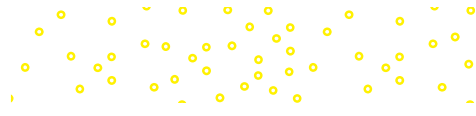
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Dedicated to

Barb, Harrison, and Daniel, my Mom, and (memory of) my Dad.

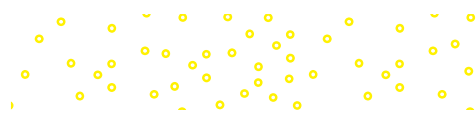
FRED PHILLIPS

Chad, Abigail, and Emily.

SHANA CLOR-PROELL

Herman and Doris Hargenrater; Laura, Oscar, and Selma Libby;
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PATRICIA AND ROBERT LIBBY



Meet the Authors



Dawn Stranden Photography

Fred Phillips

Fred Phillips is professor emeritus at the University of Saskatchewan. Most of his teaching has focused on introductory financial accounting at the University of Saskatchewan, the University of Texas at Austin, and the University of Manitoba. Fred has an undergraduate accounting degree and a PhD from the University of Texas at Austin. He is a nonpracticing CPA, CA (Canada), having previously worked as an audit manager at KPMG.

Fred has been recognized with numerous accounting education awards, as chosen by his students and peers. Most notably, Fred was awarded the title Master Teacher at the University of Saskatchewan and he was admitted to the 3M National Teaching Fellowship, the highest honor for undergraduate teaching in Canada. His peer-reviewed publications include education-focused research and instructional cases in *Issues in Accounting Education*, as well as professional judgment studies in *Journal of Accounting Research* and *Organizational Behavior and Human Decision Processes*, among others. His most recent publication, in *Issues in Accounting Education* in February 2020, examines effective use of SmartBook technology. In his spare time, Fred is a professional tennis line umpire, having worked ATP, ITF, WTA, and Grand Slam tournaments in Canada, Mexico, New Zealand, and the United States.

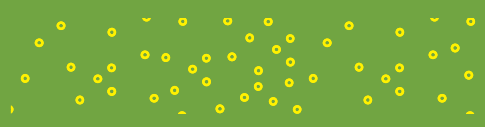


Courtesy of Glen Ellman

Shana Clor-Proell

Shana Clor-Proell is an associate professor at Texas Christian University, where she teaches introductory financial accounting and advanced accounting. She has also taught at Cornell University, the University of Wisconsin, the University of California–San Diego, and San Diego State University. Shana received her BS, MS, and PhD from Cornell University. She is a CPA (Wisconsin) and previously worked as an auditor for Arthur Andersen.

Shana's research examines judgment and decision making in financial accounting contexts. Her work has been published in *The Accounting Review*, *Journal of Accounting Research*, *Contemporary Accounting Research*, *Journal of Financial Reporting*, and *Journal of Business Ethics*. Shana is a member of the Teaching, Learning and Curriculum (TLC), Financial Accounting and Reporting (FAR), and Accounting, Behavior and Organizations (ABO) sections of the American Accounting Association. In her spare time, Shana enjoys long walks, meditation, and spending time with her husband and two daughters.



Robert Libby

Robert Libby is the David A. Thomas Professor of Accounting and Accounting Area Coordinator at Cornell University, where he teaches the introductory financial accounting course. He previously taught at the University of Illinois, Pennsylvania State University, the University of Texas at Austin, the University of Chicago, and the University of Michigan. He received his BS from Pennsylvania State University and his MAS and PhD from the University of Illinois; he also successfully completed the CPA exam (Illinois).

Bob was selected as the AAA Outstanding Educator in 2000 and received the AAA Outstanding Service Award in 2006 and the AAA Notable Contributions to the Literature Award in 1985 and 1996. He has received the Core Faculty Teaching Award multiple times at Cornell. Bob is a widely published author and researcher specializing in behavioral accounting. He has published numerous articles in *The Accounting Review*; *Journal of Accounting Research*; *Accounting, Organizations, and Society*; and other accounting journals. He has held a variety of offices, including vice president, in the American Accounting Association, and he is a member of the American Institute of CPAs.



Courtesy of Robert Libby

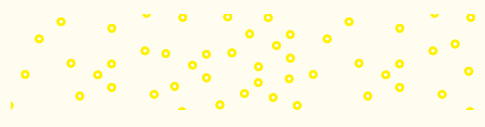
Patricia A. Libby

Patricia Libby is a retired associate professor of accounting at Ithaca College, where she taught the undergraduate and graduate financial accounting courses. She previously taught graduate and undergraduate financial accounting at Eastern Michigan University and the University of Texas. Before entering academia, she was an auditor with Price Waterhouse (now PricewaterhouseCoopers) and a financial administrator at the University of Chicago. She was also faculty advisor to Beta Alpha Psi (Mu Alpha chapter), the National Association of Black Accountants (Ithaca College chapter), and Ithaca College Accounting Association.

Patricia received her BS from Pennsylvania State University, her MBA from DePaul University, and her PhD from the University of Michigan; she also successfully completed the CPA exam (Illinois). She has published articles in *The Accounting Review*, *Issues in Accounting Education*, and *The Michigan CPA*.



Courtesy of Patricia A. Libby



Engaging Students with Real-World Context and Business

One of the most widely used introductory accounting textbooks, Phillips, *Fundamentals of Financial Accounting* focuses on four key attributes:

- **Engaging Writing and Illustrations**
- **Data-Driven Pedagogy**
- **Entrepreneurial Approach**
- **Video Asset Variety**

Phillips does an *excellent job of writing* at a level the average student will understand. [The authors] . . . know how to *engage the students* by using real companies; discussing relevant current events; using colorful, enticing-to-read graphs that are efficient at making a point; and most importantly, they know the frequent misconceptions and typical issues students have.




—Nancy Lynch, West Virginia University

Engaging Writing and Illustrations

Not all students learn financial accounting easily. In today's fast-paced world, it can be difficult to keep both majors and nonmajors focused on how accounting is relevant to them and their future careers. Through clear and engaging writing paired with vibrant illustrations, the financial decisions that companies make and the financial statements that they use come alive for students. The Phillips text helps students see the big picture of how accounting relates to the real world—their world.

EXHIBIT 6.4

“Delivery” as FOB Shipping Point or FOB Destination

				
	Loading	In Transport	Unloading	Explanation
FOB Shipping Point	Seller responsible	Buyer responsible		“Delivery” occurs when the seller loads onto truck.
FOB Destination	Seller responsible		Buyer responsible	“Delivery” occurs when ready for buyer to unload.

Driving Learning with Clear, Effective, and Innovative Ideas

Data-Driven Pedagogy: A Proven Teaching and Learning Methodology

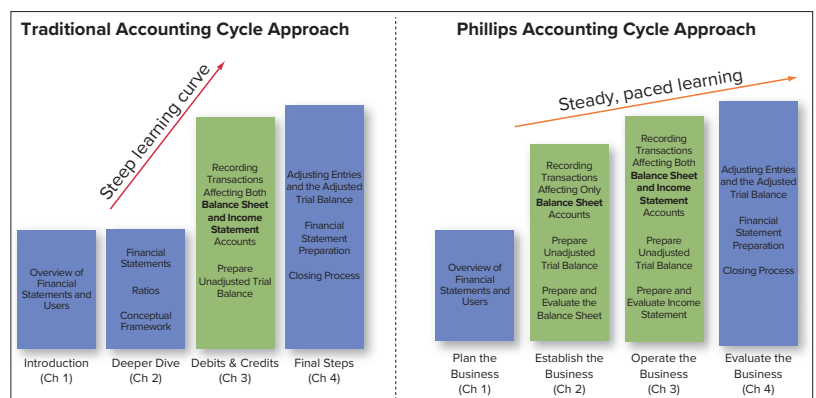
Faculty agree that for students studying financial accounting, the accounting cycle is the most critical topic to learn and master. The approach to this topic in the Phillips text is based on the belief that students struggle with the accounting cycle when transaction analysis is covered in one chapter. If students are exposed to the accounting equation, journal entries, and T-accounts for both balance sheet and income statement accounts in a single chapter, they can feel overwhelmed and are unable to grasp material in the next chapter, which typically covers adjustments and financial statement preparation.

The authors' peer-reviewed research on various approaches to teaching the accounting cycle informed the step-by-step model used in the text—a model proven to lead to better results in short-term assessment as well as in long-term understanding and application of the material. In a study published in *Issues in Accounting Education*, author Fred Phillips and his research partner Lindsay Heiser studied the effects of teaching the accounting cycle by initially restricting the scope of transactions to only those affecting balance sheet accounts, while waiting to introduce transactions involving both balance sheet and income statement accounts until later.

The results showed that students who learned the accounting cycle via the scaffolded approach were better able to prepare journal entries on similar types of transactions both immediately and one week later. Importantly, these same students later performed just as well on complex transactions affecting balance sheet *and* income statement accounts despite having had less practice with them. The scaffolded accounting cycle approach that proved so effective in this study is the same that is used in *Fundamentals of Financial Accounting*, helping students to “work smarter,” and better preparing them for success in financial accounting and beyond.

The graphic below shows how, unlike other texts, Phillips spreads transaction analysis coverage over two chapters so that students have the time to master the material. In Chapter 2, students are exposed to the accounting equation and transaction analysis for transactions that affect only balance sheet accounts. This provides students with the opportunity to learn the basic structure and tools used in accounting in a simpler setting. In Chapter 3, students are exposed to more complex transactions that affect both balance sheet and income statement accounts. As a result of this progressive approach to transaction analysis, students learn more, as documented in peer-reviewed research.* This innovative organization also prepares students to better understand adjustments, financial statement preparation, and more advanced topics.

In addition, the accounting cycle approach used here tells a natural business story—one that would be familiar to any modern entrepreneur. From planning and establishing the business to opening and evaluating the business, the first few chapters clearly break out each key stage in starting a company. The accounting cycle coverage steadily unfolds as students move along this company's journey, allowing them to keep pace and absorb how accounting events unfold in the real world of business.



[The topics covered in the first three chapters are] the toughest for students and require the most practice. Phillips understands this and expertly navigates through the two statements and demonstrates how the two interconnect and depend upon each other, setting the stage for an easier adjustment and closing process ahead.

—Margaret Costello Lambert, Oakland Community College

*F. Phillips and L. Heiser, “A Field Experiment Examining the Effects of Accounting Equation Emphasis and Transaction Scope on Students Learning to Journalize,” *Issues in Accounting Education* 26 (2011), pp. 681–699.

Modern Businesses Engage Students



Doug Lemke/Shutterstock

Entrepreneurial Approach: Inspiring Students

The authors of *Fundamentals of Financial Accounting* understand the challenges instructors face and the need for a financial accounting text that is relevant, easy to read, and current.

Fundamentals of Financial Accounting responds by using **carefully chosen focus companies that students recognize and engage with in their everyday lives**. From tech start-ups to some of the world's most familiar trademark brands, each chapter opens with an engaging scenario or story using a familiar company. The same focus company, such as **Walmart**, **Cedar Fair**, **American Eagle**, **National Beverage**, **Under Armour**, or **General Mills**, is used throughout the entire chapter so that students can see how the concepts and calculations apply to a real-world company they are already familiar with.

Today's students have grown up hearing about start-up culture, and many are entrepreneurially minded having seen the rise of **Apple**, **Facebook**, and the "gig economy." The authors showcase accounting's relevance by using **Noodlecake Studios**, a digital start-up, as the company profiled in Chapters 1–4. With this example, students see how a new small business uses accounting, from planning to evaluation of financial performance.



Written in *clear, understandable language* . . . The multiple *real-world examples, colorful and "clean" exhibits*, as well as other illustrations *enhance the student's learning process* by making the information relevant and understandable. The *"building block" approach* allows the student to gain a *solid understanding* of the fundamentals of each chapter before moving on to the next.

—Muriel Anderson, *SUNY–Buffalo*

by Bringing Accounting Concepts to Life

Video Asset Variety: Present, Expand, and Reinforce Key Concepts

Modern businesses expect their employees to be lifelong learners. As a result, businesses and educators increasingly rely on videos as “just-in-time” resources to present, reinforce, and augment critical concepts. Whether the viewer is a student in a classroom or a newly hired CPA at a Big 4 accounting firm, learning on the go via a variety of multimedia-based assets is key in both the corporate world and academic settings. *Fundamentals of Financial Accounting* provides a range of video offerings and formats to facilitate understanding and help students learn wherever and whenever they need to.

Video Type/Purpose	Description
Tutorial Videos: Explaining the basics	
Concept Overview Videos	Assignable in Connect , these videos cover each chapter’s learning objectives followed by auto-graded knowledge checks that confirm students’ comprehension. A great tool for introducing students to new topics.
Guided Examples	Narrated, animated, step-by-step walkthroughs of an exercise similar to assignment exercises, that provide just-in-time help for students when they are working on assignments.
In Action Videos	Assignable in Connect , these tutorial videos illustrate the thought processes applicable to a sample of topics in <i>Fundamentals of Financial Accounting</i> , including how to analyze transactions, adjust accounts, account for inventory and receivables, and prepare a statement of cash flows.
Featured Videos: Engaging deeper	
Spotlight Videos	Assignable in Connect , selected Spotlight on Ethics, Financial Reporting, and Business Decisions feature boxes in the text are brought to life in 2- to 5-minute news magazine-style videos. Assign students the tasks of watching the video and answering comprehension-check questions.
Flash Topic Videos	Assignable in Connect , these videos extend ideas in the text for hot topics including revenue recognition, big data, sales returns, stock buybacks, and sustainability. Assign students the tasks of watching the video and answering comprehension-check questions. NEW! Several new videos illustrate the impact of the Covid-19 pandemic on selected business operations and financial results using companies familiar to students.


“Clear, concise, and the most reader-friendly text I’ve come across. Most importantly, it is based on sound learning theory, which greatly enhances the learning experience.”

—Professor Audrey Agnello, Niagara County Community College

From Concepts to Comprehension— Reinforcement Is Key

Whether you're presenting, discussing, or problem solving, you want materials that will motivate students and hold their interest. Motivating today's students requires materials that connect them with the workplace and encourage them to think about course topics before, during, and after class. *Fundamentals of Financial Accounting* offers students many tools to help reinforce the concepts discussed throughout the text.

Picture



← Receives
Gives →

Name

- Noodlecake has received \$20,000 cash.
- Noodlecake gave a note, payable to the bank for \$20,000.

Analyze

	=		+	
Assets		Liabilities		Stockholders' Equity
(c) Cash +20,000		= Notes Payable		+20,000

COACH'S TIP

Notes payable are like accounts payable except they (a) charge interest, (b) can be outstanding for periods either shorter or longer than one year, and (c) are documented using formal documents called notes.


Logo: Noodlecake Studios Inc.; Money photo: Comstock/Getty Images; Money photo: Comstock/Getty Images

Coach's Tips

Every student needs encouragement and Coach's Tips are just one way *Fundamentals of Financial Accounting* fulfills that need. Coach's Tips appear throughout the text and in selected end-of-chapter problems to offer tips, advice, and suggestions.

How's it going? Self-Study Practice

Research shows that students learn best when they are actively engaged in the learning process. This active learning feature engages the student, provides interactivity, and promotes efficient learning. These quizzes ask students to pause at strategic points throughout each chapter to ensure they understand key points before moving ahead.

 **How's it going?**

Self-Study Practice

For each item listed below, indicate whether the company should report it on the income statement this period (yes/no). If yes, indicate an appropriate account title for the item described.

Description	Yes/No	Account Title
1. Bank of America charges customers a monthly service fee.	_____	_____
2. Target buys a new building to use as a retail store.	_____	_____
3. Dell pays to deliver computers to customers.	_____	_____
4. Pizza Hut buys supplies to be used next month.	_____	_____
5. Snap pays this week's wages to employees.	_____	_____

After you have finished, check your answers with the solution.

Phillips does an **outstanding job of incorporating real-world data into the text**, which increases a student's engagement with the material and enhances their learning. I think that the writing style is very conversational, which makes reading the chapter a manageable task for the students.

—Anne Clem, Iowa State University

 SPOTLIGHT
ON

Financial Reporting

Expected Impacts of COVID-19

A surge of 8-Ks were filed soon after the COVID-19 crisis reached the United States in early 2020. An example excerpted from Disney's 8-K follows:

The impact of the novel coronavirus ("COVID-19") and measures to prevent its spread are affecting our businesses in a number of ways. We have closed our theme parks; suspended our cruises and theatrical shows; delayed theatrical distribution of films both domestically and internationally; and experienced supply chain disruption and ad sales impacts.

Source: The Walt Disney Company, Form 8-K filed March 18, 2020. Retrieved on March 19, 2020, from sec.gov.

Spotlight Features


Each chapter includes Spotlight features focusing on business decisions, ethics, internal controls, financial reporting, big data and analytics, and the world (IFRS). These features are designed to further engage students and provide instructors with material for in-class discussion.

- **Spotlight on Big Data and Analytics**—highlights topics relating to big data, data visualization, and data and business analytics.
- **Spotlight on the World**—highlights significant differences between U.S. GAAP and IFRS.
- **Spotlight on Financial Reporting**—connects chapter topics with real-world disclosures provided in the financial statements of our focus companies and other contrast companies.
- **Spotlight on Controls**—highlights applications of internal control principles in the workplace.
- **Spotlight on Ethics**—emphasizes ethical issues and the importance of acting responsibly.
- **Spotlight on Business Decisions**—helps students develop strong decision-making skills by illustrating the relevance of accounting in real-world decision making.

Practice and Review Materials

Build Confidence and Success



To effectively evaluate and guide student success with the appropriate feedback, instructors need homework and test materials that are **easy to use** and tied to the chapter discussions. Each chapter of *Fundamentals of Financial Accounting* is followed by an extensive variety of end-of-chapter material that applies and integrates topics presented in the chapter.

- **Demonstration Case:** End-of-chapter review material begins with a demonstration case that provides another self-study opportunity for students. The demonstration case is practice material that previews what students will see in the homework problems.
- **Homework Helper** immediately precedes each chapter's homework materials, highlighting subtleties discussed in the chapter and providing practical advice so students avoid common pitfalls when completing homework assignments.
- **Multiperspective Discussion Questions:** These questions ask students to explain and discuss terms and concepts presented in the chapter. Selected questions, denoted with an icon , help students begin developing critical thinking skills.
- **Mini Exercises, Exercises, Problems (Coached, Group A, and Group B):** Each chapter includes a wide variety of assignment material from questions that illustrate and apply a single learning objective to problem sets that help students develop decision-making skills.

- **Level-up Questions:**



In each chapter, particularly challenging questions, designated by the level-up icon, require students to combine multiple concepts to advance to the next level of accounting knowledge.

- **Comprehensive Problems:** Selected chapters include problems that cover topics from earlier chapters to refresh, reinforce, and build an integrative understanding of the course material. These are a great resource for helping students stay up-to-date throughout the course.
- **Questions** designated with the **general ledger** icon have been written to take advantage of Connect's general ledger simulation. A much-improved student experience when working with accounting cycle questions, students' work in the general journal is automatically posted to the ledger, navigation is much simpler, and students can easily link back to their original entries simply by clicking in the ledger if edits are needed. These questions include critical thinking components to maximize students' foundational knowledge of accounting concepts and principles. 
- **Skills Development Cases:** Each chapter offers cases designed to help students develop analytical, critical thinking, and technology skills. These cases are ideal for individual assignments and group projects. They also encourage your students to find financial information in an actual annual report. The first two cases of every chapter present, in multiple-choice format, an opportunity to connect your students with real-world financial reporting. These are assignable in Connect.
- **Continuing Case:** In Chapter 1, students are introduced to Nicole's Getaway Spa (NGS). In the following chapters, this continuing case is extended to encompass each new topic.
- **Data Analytics Exercises:** These auto-graded exercises, assignable in Connect, introduce students to data visualization, interpretation, and analysis relevant to topics in selected chapters. 



The end-of-chapter *problems and exercises* are *ample, diverse* (in terms of rigor), and *congruent* with the material covered in the chapter.

—Brian Nagle, Duquesne University



What's New in the Seventh Edition?

In response to feedback and guidance from numerous financial accounting faculty, the authors have made many important changes in the seventh edition of *Fundamentals of Financial Accounting*, including the following:

- Integrated **new companies**, including a new focus company (**Dave & Buster's**) and many other companies familiar to students (**Alphabet, Apple, Domino's Pizza, Facebook, Garmin, Sonos, Zumiez**, and so on).
- Reviewed, updated, and introduced new end-of-chapter material in each chapter to support new topics and learning objectives, including auto-graded **Data Analytics Exercises** in Connect involving data visualization, interpretation, and analysis.
- Incorporated throughout the text are discussions of the **effect of the COVID-19 pandemic** on businesses to drive relevancy and engagement.

CHAPTER 1: BUSINESS DECISIONS AND FINANCIAL ACCOUNTING

Focus Company: **Noodlecake Studios**

- **Updated** chapter opener describing the latest developments at this private company and its development of award-winning video games
- **Updated** Supplement 1B to describe the SEC's direct listing option, as pursued by **Spotify**
- **New** discussion of COVID-19 impact on 8-K reporting in Spotlight on Financial Reporting
- **Updated** demonstration case featuring **WD-40 Company**
- Reviewed and updated all end-of-chapter material, including financial data for **Apple, Alphabet, Intel, Designer Brands, Cinemark, Garmin**, and others

CHAPTER 2: THE BALANCE SHEET

Focus Company: **Noodlecake Studios**

- **Updated** analysis of current ratios in Exhibit 2.14 for video game companies **Activision Blizzard, Electronic Arts**, and **Take-Two Interactive Software**
- Reviewed and updated all end-of-chapter material, including financial data for **Columbia Sportswear, Ethan Allen Interiors, Facebook, Shake Shack**, and others

CHAPTER 3: THE INCOME STATEMENT

Focus Company: **Noodlecake Studios**

- **Updated** illustrations in Exhibits 3.6 and 3.7
- **Updated** net profit margin ratios at **Electronic Arts** and **Nintendo** in Spotlight on Financial Reporting
- **Updated** demonstration case featuring **Carnival Corporation**
- Reviewed and updated all end-of-chapter material, including financial data for **Expedia, Booking.com, The Home Depot**, and others

CHAPTER 4: ADJUSTMENTS, FINANCIAL STATEMENTS, AND FINANCIAL RESULTS

Focus Company: **Noodlecake Studios**

- **Updated** illustrations in Exhibit 4.14
- **New** analysis of stock price and earnings for **Sears Holdings** in Spotlight on Financial Reporting
- Reviewed and updated all end-of-chapter material, including financial data for **FedEx Corporation, Regis Corporation, Lowe's**, and others

CHAPTER 5: FRAUD, INTERNAL CONTROL, AND CASH

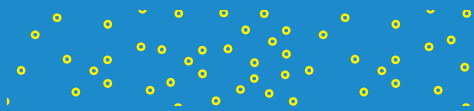
Focus Company: **Koss Corporation**

- **Updated** data relating to frequency and losses from employee fraud in Exhibit 5.1
- **Updated** illustration of restricted cash reporting at **Domino's Pizza** (Exhibit 5.10)
- Reviewed, updated, and introduced new end-of-chapter material, including financial data for **Expedia, The Home Depot**, and others

CHAPTER 6: MERCHANDISING OPERATIONS AND THE MULTISTEP INCOME STATEMENT

Focus Company: **Walmart**

- **Updated** focus company illustrations (**Walmart**) and contrasted with **Planet Fitness** (Exhibit 6.2)
- **Updated** data regarding inventory shrinkage costs in Spotlight on Controls
- **New** illustration of FOB Shipping Point and FOB Destination in Exhibit 6.4
- **New** discussion of using a contra-revenue account for sales returns and allowances
- **Updated** illustration of gross profit percentage analysis at **Walmart** and **Nordstrom**



CHAPTER 6: (continued)

- Reviewed, updated, and introduced new end-of-chapter material, including financial data for **Dillard's**, **Luxottica**, **Fortune Brands**, **The Gap**, **Macy's**, and others

CHAPTER 7: INVENTORY AND COST OF GOODS SOLD

Focus Company: **American Eagle Outfitters**

- **Updated** focus company illustrations
- **New** discussion of **Burberry** destroying its inventory in Spotlight on Business Decisions
- **Updated** inventory turnover analysis in Exhibit 7.7, involving **Harley-Davidson**, **McDonald's**, and **American Eagle**
- Reviewed and updated all end-of-chapter material, including financial data for **Sonos**, **Amazon**, **Polaris Industries**, **GameStop**, and others

CHAPTER 8: RECEIVABLES, BAD DEBT EXPENSE, AND INTEREST REVENUE

Focus Company: **VF Corporation (VFC)**

- **Updated** focus company illustrations for **VF Corp.**—the maker of **North Face** jackets, **JanSport** backpacks, **Timberland** boots, and **Vans** shoes
- **New** discussion of co-branded credit cards in Spotlight on Business Decisions
- **New** discussion of COVID-19 impact on collection of accounts receivable in Spotlight on Business Decisions
- **Updated** receivables turnover analysis in Exhibit 8.7, involving **VF Corp.**, **Post**, and **Apple**
- Reviewed and updated all end-of-chapter material, including financial data for **Adobe**, **Callaway Golf**, **Microsoft**, **FedEx**, and others

CHAPTER 9: LONG-LIVED TANGIBLE AND INTANGIBLE ASSETS

Focus Company: **Cedar Fair**

- **Updated** focus company illustrations
- **New** discussion of COVID-19 impact on asset impairment losses
- **New** discussion of leased assets in Spotlight on Financial Reporting
- **Updated** fixed asset turnover analysis in Exhibit 9.5, involving **Cedar Fair**, **Six Flags**, and **Facebook**

- Reviewed and updated all end-of-chapter material, including financial data for **Apple**, **Hasbro**, and others

CHAPTER 10: LIABILITIES

Focus Company: **General Mills**

- **Updated** focus company illustrations
- **Updated** discussion of bond pricing
- **Updated** analysis of debt-to-assets and times interest earned ratios for **Kellogg**, **Post**, and **Campbell Soup** comparison companies
- **Simplified** presentation of installment notes in Supplement 10D
- Reviewed and updated all end-of-chapter material, including financial data for **FedEx Corporation**, **Lowe's**, and others

CHAPTER 11: STOCKHOLDERS' EQUITY

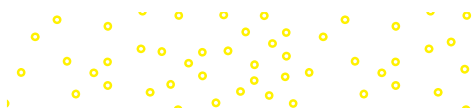
Focus Company: **National Beverage Corp.**

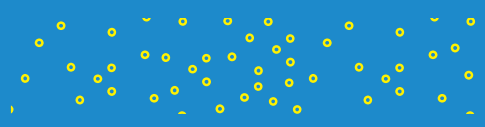
- **Updated** focus company illustrations, as well as stock prices of rivals **Coca-Cola** and **PepsiCo**
- **Updated** Spotlight on Business Decisions relating to the impact of stock repurchases on EPS at **Boeing**, and more recently at **Delta** and **Southwest Airlines**
- **Updated** Spotlight on Business Decisions relating to **National Beverage's** investor loyalty plan
- **Updated** ratio analyses in Exhibit 11.6, involving **National Beverage** and **PepsiCo**
- Reviewed and updated all end-of-chapter material, including financial data for **General Mills**, **Stanley Black & Decker**, **Delta**, **Southwest Airlines**, and others

CHAPTER 12: STATEMENT OF CASH FLOWS

Focus Company: **Dave & Buster's**

- **New** focus company
- **Updated** illustration of cash flow patterns in Exhibit 12.8
- **New** Spotlight on Financial Reporting relating to **Dave & Buster's** free cash flow
- Reviewed and updated all end-of-chapter material, including financial data for **Colgate-Palmolive**, **Walt Disney Company**, **Zumiez**, **Cedar Fair**, and others





CHAPTER 13: MEASURING AND EVALUATING FINANCIAL PERFORMANCE

Focus Company: **Lowe's**

- **Updated** focus company analyses
- **New** discussion of COVID-19 impact on going-concern status in Spotlight on Financial Reporting
- Reviewed and updated all end-of-chapter material, including financial data for **Chevron**, **Cintas**, **Procter & Gamble**, **Dollar General**, **Kohl's**, and others

APPENDIXES A & B: EXCERPTS FROM ANNUAL REPORTS OF THE HOME DEPOT AND LOWE'S

- Updated excerpts from the Fiscal 2019 10-K Annual Reports of **The Home Depot** and **Lowe's**

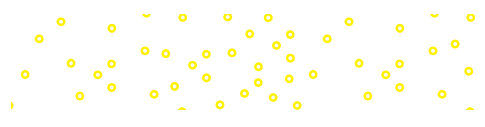
APPENDIX C: PRESENT AND FUTURE VALUE CONCEPTS

- Reviewed and updated all end-of-chapter material

APPENDIX D: INVESTMENTS IN OTHER CORPORATIONS

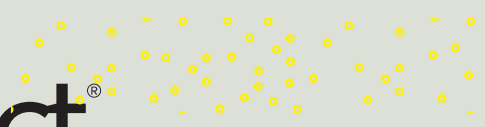
Focus Company: **Alphabet Inc.**

- **Updated** focus company illustrations
- Reviewed and updated all end-of-chapter material





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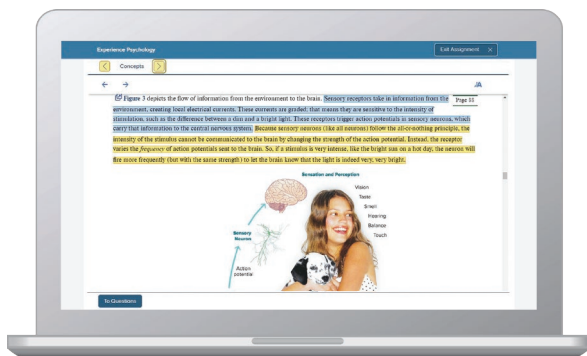
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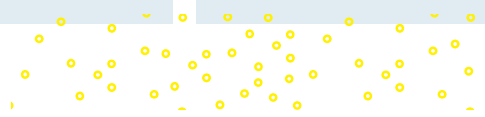
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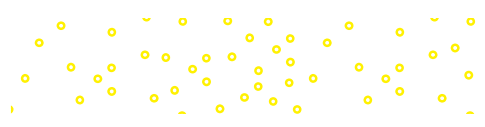
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Remote Proctoring & Browser-Locking Capabilities



New remote proctoring and browser-locking capabilities, hosted by Proctorio within Connect, provide control of the assessment environment by enabling security options and verifying the identity of the student.

Seamlessly integrated within Connect, these services allow instructors to control students' assessment experience by restricting browser activity, recording students' activity, and verifying students are doing their own work. Instant and detailed reporting gives instructors an at-a-glance view of potential academic integrity concerns, thereby avoiding personal bias and supporting evidence-based claims.

Online Assignments

Connect helps students learn more efficiently by providing feedback and practice material when they need it, where they need it. Connect grades homework automatically and gives immediate feedback on any questions students may have missed. The extensive assignable, gradable end-of-chapter content includes a general journal application that looks and feels more like what you would find in a general ledger software package. Also, select questions have been redesigned to test students' knowledge more fully. They now include tables for students to work through rather than requiring that all calculations be done offline.

End-of-chapter questions in Connect include

- Mini-Exercises
- Exercises
- Problems (Coached, Group A, and Group B)
- Comprehensive Problems
- Skills Development Cases
- Continuing Cases

NEW! Writing Assignment

Available within McGraw Hill Connect,[®] the Writing Assignment tool delivers a learning experience to help students improve their written communication skills and conceptual understanding. As an instructor you can assign, monitor, grade, and provide feedback on writing more efficiently and effectively.

NEW! Tableau Dashboard Activities

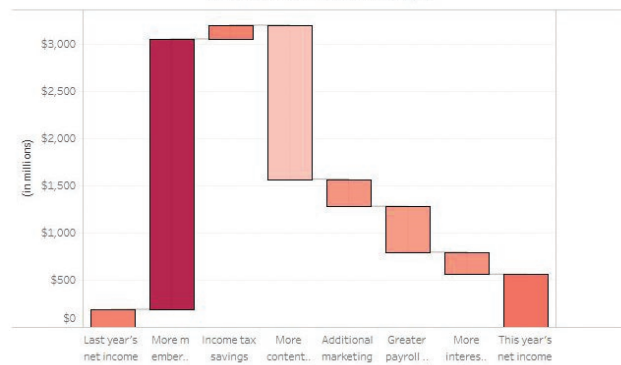


Tableau Dashboard Activities allow students to explore live Tableau dashboards directly integrated into Connect, and include auto-graded questions focused on both calculations and analysis. Students can check their understanding and apply what they are learning within the framework of analytics and critical thinking.

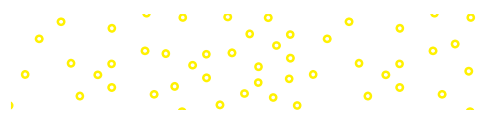
General Ledger Problems

General Ledger Problems provide a much-improved student experience when working with accounting cycle questions, offering improved navigation and less scrolling. Students can audit their mistakes by easily linking back to their original entries and

Newflix's Net Income Changes



Newflix's Changes in Cash Position



Requirement: General Journal, General Ledger, Trial Balance, Income Statement, Balance Sheet, Analysis

Each Journal entry is posted automatically to the general ledger. Use the drop-down button to view the unadjusted, adjusted, or post-closing balances.

Adjusted

General Ledger Account

Cash					Accounts Receivable				
No.	Date	Debit	Credit	Balance	No.	Date	Debit	Credit	Balance
	Dec 01			9,300		Dec 01			1,920
5	Dec 04	830		10,130	3	Dec 03	2,090		4,010
6	Dec 18		1,580	8,550	5	Dec 04		830	3,180
7	Dec 23		450	8,100					

Inventory					Prepaid Rent				
No.	Date	Debit	Credit	Balance	No.	Date	Debit	Credit	Balance
	Dec 01			400		Dec 01			660
1	Dec 01	208		608	12	Dec 31		110	550
2	Dec 02	495		1,103					
4	Dec 03		993	110					

Equipment					Accumulated Depreciation—Equipment				
No.	Date	Debit	Credit	Balance	No.	Date	Debit	Credit	Balance
	Dec 01			860		Dec 01			99
					10	Dec 31		9	99

Accounts Payable					Salaries and Wages Payable				
No.	Date	Debit	Credit	Balance	No.	Date	Debit	Credit	Balance
	Dec 01			1,340		Dec 01			300
1	Dec 01		208	1,548	7	Dec 23	260		40
2	Dec 02		495	2,043	11	Dec 31		100	140
6	Dec 18	1,580		463					
9	Dec 31		170	633					

Income Taxes Payable					Common Stock				
No.	Date	Debit	Credit	Balance	No.	Date	Debit	Credit	Balance
	Dec 01			0		Dec 01			6,000
13	Dec 31		700	700					

Requirement: General Journal, General Ledger, Trial Balance, Income Statement, Balance Sheet, Analysis

Notice the dropdown below that gives the options to select the unadjusted, adjusted or post-closing trial balance. The option you choose will be the values used to populate the income statement and balance sheet tabs.

Adjusted

COLLEGE COASTERS
Trial Balance
December 31, 2020

Account Title	Debit	Credit
Cash	\$ 8,100	
Accounts Receivable	3,180	
Inventory	110	
Prepaid Rent	550	
Equipment	860	
Accumulated Depreciation—Equipment		99
Accounts Payable		633
Salaries and Wages Payable		140
Income Taxes Payable		700
Common Stock		6,000
Retained Earnings		2,700
Sales Revenue		16,310
Cost of Goods Sold	8,203	
Depreciation Expense	99	
Office Expenses	1,470	
Rent Expense	1,320	
Salaries and Wages Expense	1,900	
Income Tax Expense	700	
Total	\$ 26,582	\$ 26,582

< General Ledger | Income Statement >

can see how the numbers flow through the various financial statements. Many General Ledger Problems include an analysis tab that allows students to demonstrate their critical thinking skills and a deeper understanding of accounting concepts.

Concept Overview Videos

The **Concept Overview Videos** provide engaging narratives of key topics in an assignable and interactive online format. They follow the structure of the text and are organized to match the chapter's learning objectives. The Concept Overview Videos provide additional explanation and enhancement of material from the text chapter, allowing students to learn, study, and practice with instant feedback, at their own pace.

Excel Simulations

Simulated Excel Questions, assignable within Connect, allow students to practice their Excel skills—such as basic formulas and formatting—within the context of financial accounting. These questions feature animated, narrated Help and Show Me tutorials (when enabled), as well as automatic feedback and grading for both students and professors.

Guided Examples/Hint Videos

The **Guided Examples** in Connect provide a narrated, animated, step-by-step walk-through of select exercises similar to those assigned. These short presentations can be turned on or off by instructors and provide reinforcement when students need it most.

Unadjusted Trial Balance

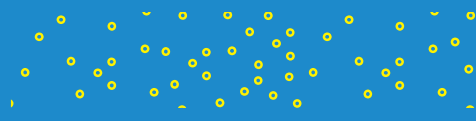
SONICGATEWAY, INC.
Unadjusted Trial Balance
At September 30

Account Name	Debits	Credits
Cash	\$16,900	
Accounts Receivable	500	
Supplies	600	
Prepaid Rent	7,200	
Equipment	9,600	
Software	9,000	
Logo and trademarks	300	
Accounts Payable		\$10,700
Unearned Revenue		300
Note Payable		20,000
Common Stock		10,000
Retained Earnings		0
Sales Revenue		12,000
Salaries and Wages Expense	7,800	
Utilities Expense	600	
Advertising Expense	500	
Totals	\$53,000	\$53,000

Debits = Credits

Knowledge Check 01

A trial balance can best be explained as a list of:



Test Builder in Connect

Available within Connect, **Test Builder** is a cloud-based tool that enables instructors to format tests that can be printed or administered within an LMS. Test Builder offers a modern, streamlined interface for easy content configuration that matches course needs, without requiring a download.

Test Builder allows you to:

- Access all test bank content from a particular title.
- Easily pinpoint the most relevant content through robust filtering options.
- Manipulate the order of questions or scramble questions and/or answers.
- Pin questions to a specific location within a test.
- Determine your preferred treatment of algorithmic questions.
- Choose the layout and spacing.
- Add instructions and configure default settings.

Test Builder provides a secure interface for better protection of content and allows for just-in-time updates to flow directly into assessments.

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Many educational institutions today are focused on the notion of *assurance of learning*, an important element of some accreditation standards. *Fundamentals of Financial Accounting* is designed specifically to support your assurance of learning initiatives with a simple, yet powerful solution.

Each test bank question for *Fundamentals of Financial Accounting* maps to a specific chapter learning objective listed in the text. You can use Connect to easily query for learning outcomes/objectives that directly relate to the learning objectives for your course. You can then use the reporting features of Connect to aggregate student results in a similar fashion, making the collection and presentation of assurance of learning data simple and easy.

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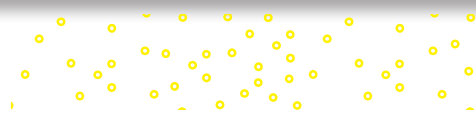
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Acknowledgments

We are deeply indebted to the following individuals who helped develop, critique, and shape the extensive ancillary package:

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Linda Vaello, *University of Texas–San Antonio*

We are equally grateful to the reviewers over the past six editions who have helped inform the development of this text, and whose ideas have aided thousands of students.



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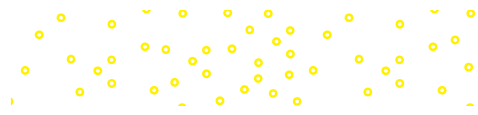
Solutions to Multiple-Choice Questions Q1

Chart of Accounts CA1

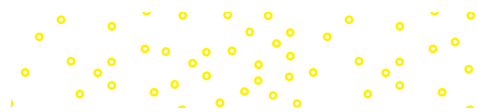
Glossary G1

Company Index IND1

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Fundamentals of FINANCIAL ACCOUNTING





1

Business Decisions and Financial Accounting

CHAPTER ONE

YOUR LEARNING OBJECTIVES

- LO 1-1** Describe various organizational forms and business decision makers.
- LO 1-2** Describe the purpose, structure, and content of the four basic financial statements.
- LO 1-3** Explain how financial statements are used by decision makers.
- LO 1-4** Describe factors that contribute to useful financial information.
- LO 1-S1** Describe examples where accounting helps in pursuing other business careers.
- LO 1-S2** Describe the decision to become a public company and explain the implications for accounting.

THAT WAS THEN

If you think accounting is far removed from your personal life, you might be in for a surprise. Your ordinary life experiences, especially as a student, actually prepare you well to learn accounting.



FOCUS COMPANY: NOODLECAKE STUDIOS, INC.



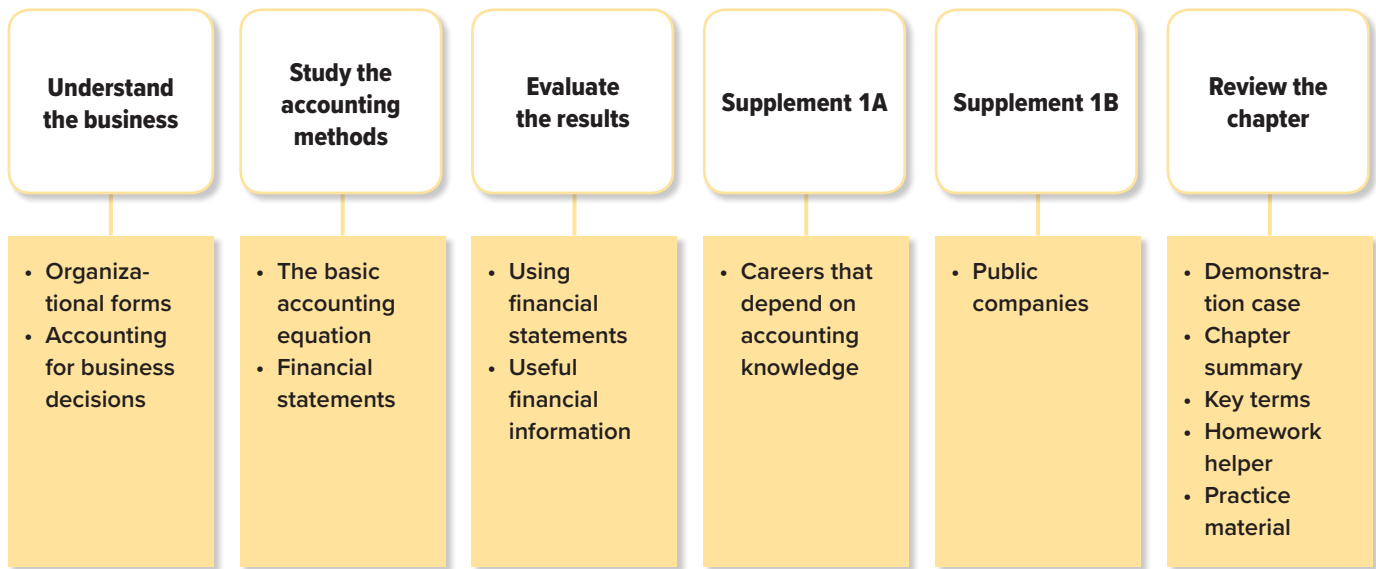
Welcome to the world of business and financial accounting. One of our goals for this book is to help you see the role accounting plays in helping people turn their good ideas into successful businesses. In the first four chapters of this book, you will learn how two video game developers started a business and learned to use accounting to run their business with great success.

For Jordan Schidlowsky and Ty Bader, the last few years have been incredible. Their *Super Stickman Golf* series and other game apps they've developed for mobile devices have won awards and recognitions on iTunes and Google Play. The crowning achievement (so far) was being awarded an Apple Design Award for their game *Chameleon Run*. Their chief operating officer, Ryan Holowaty, says it's like winning an Academy Award. They continue to grow their business, now developing and publishing games for not only the iPhone and Android, but also game consoles, PCs, and Apple Arcade. They have benefited greatly from the advice of Laurie Norris—a CPA (certified public accountant)—who has helped them establish their business and understand how to monitor its success. As you will read in this chapter, things got rolling when Laurie met with Jordan in June to answer his questions about how to get started. By following Laurie's business and accounting advice, Jordan and Ty successfully launched their company, named **Noodlecake Studios, Inc.** (noodlecake.com).

THIS IS NOW

This chapter focuses on the key financial reports that business people rely on when evaluating a company's performance.

ORGANIZATION OF THE CHAPTER



Understand the Business

“Jordan, we should start by talking about how you want to organize your business.”



“Well, I’m starting a technology company to sell apps in Apple’s App Store and on Google Play. What else do I need to know?”

Learning Objective 1-1

Describe various organizational forms and business decision makers.

ORGANIZATIONAL FORMS

Laurie outlined three primary ways businesses can be organized: sole proprietorship, partnership, and corporation.

Sole Proprietorship

This is a form of business owned (and usually operated) by one individual. It is the easiest form of business to start because it doesn’t require any special legal maneuvers. Just get a business license and you’re good to go. A sole proprietorship is considered a part of the owner’s life, with all profits (or losses) becoming part of the taxable income of the owner, and the owner being personally liable for all debts of the business.

Partnership

A partnership is similar to a sole proprietorship, except that profits, taxes, and legal liability are the responsibility of two or more owners instead of just one. It is slightly more expensive to form than a sole proprietorship because a lawyer typically is needed to draw up a partnership agreement, which describes how profits are shared between partners and how that would

change if new partners are added or existing partners leave. The key advantage of a partnership over a sole proprietorship is that, by having more owners, a partnership typically has more resources available to it, which can help the business grow faster.

Corporation

Unlike sole proprietorships and partnerships, a corporation is a separate entity from both legal and accounting perspectives. This means the corporation, not its owners, is legally responsible for its own taxes and debts. Because legal liability is limited in this way, owners cannot lose more than their investment in the corporation, which is a major advantage to the owners. Two disadvantages of incorporation are the legal fees for creating a corporation can be expensive and income taxes must be paid by both the corporation and its owners.

Corporations can raise large amounts of money for growth because they divide ownership of the corporation into shares that can be sold to new owners. A share of the corporation's ownership is indicated on a legal document called a stock certificate. The owners of a company's stock (stockholders) can buy and sell stock privately or publicly on a stock exchange if the company has legally registered to do so. Most corporations start out as **private companies** and, as explained in Chapter Supplement 1B, will apply to become **public companies** ("go public") if they need a lot of financing, which they obtain from issuing new stock certificates to investors. Some big-name corporations, like **Cargill** and **Chick-fil-A**, haven't gone public because they get enough financing from private sources, but many that you are familiar with (and most examples in this book) are public companies.

Other

Other organizational forms exist, such as a limited liability company (LLC), which combines characteristics of a partnership and a corporation. We focus on corporations in this book.

"I'm interested in limiting my legal liability and getting some financing by selling ownership shares to investors, so I will create a private corporation called Noodlecake Studios, Inc. What's next?"



ACCOUNTING FOR BUSINESS DECISIONS

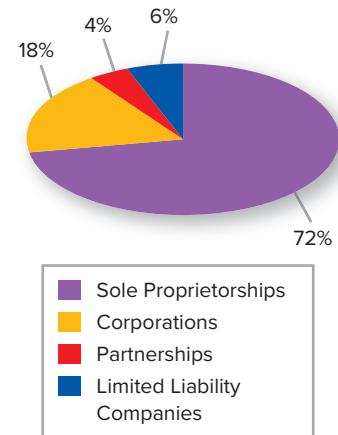
Most companies exist to earn profits for their stockholders. They earn profits by selling goods or services to customers for more than they cost to produce. **Noodlecake** will be successful if it is able to sell enough apps to cover the costs of making them and running the company. To know just how successful the company is, Jordan and Ty will need to establish and maintain a good system of financial record-keeping—an accounting system. **Accounting** is an information system designed by an organization to capture (analyze, record, and summarize) the activities affecting its financial condition and performance and then report the results to decision makers, both inside and outside the organization. It's such a key part of business that businesspeople typically talk about their companies using accounting terms, which is why they often call it the "language of business."

Every organization needs accountants to assist in reporting financial information for decision making and to help its owners understand the financial effects of those business decisions. Jordan can get this help in one of two ways. He can hire an accountant to work as an employee of his business (a **private accountant**) or he can contract with someone like Laurie who provides advice to several businesses (a **public accountant**). Because Jordan's business is small, he doesn't yet need a full-time accountant. Instead, he agrees for Noodlecake to pay fees to Laurie for basic services. She'll help him to set up an accounting system and advise him on key business decisions.

"How will an accounting system help me run my business?"



Percentage of Organizational Forms in the U.S.



Source: IRS.gov.

YOU SHOULD KNOW

Accounting: A system of analyzing, recording, and summarizing the results of a business's operating, investing, and financing activities and then reporting them to decision makers.

Photo: Jill Braaten/McGraw-Hill Education

EXHIBIT 1.1

The Accounting System Reports Information for Decision Makers



The main goal of an accounting system is to capture information about the operating, investing, and financing activities of a company so that it can be reported to decision makers, both inside and outside the business. Exhibit 1.1 illustrates this role and shows that this information can be presented in two kinds of reports. **Managerial accounting reports** include detailed financial plans and continually updated reports about the operating performance of the company. These reports are made available only to the company's employees (internal users) for making business decisions related to production, marketing, human resources, and finance. For example, managerial accounting reports are needed when determining whether to build, buy, or rent a building; whether to continue or discontinue making particular products; how much to pay employees; and how much to borrow. As manager of Noodlecake, Jordan will regularly need managerial accounting reports to monitor the number of app downloads and evaluate the various costs associated with making and selling apps.



“Financial information about your business will be needed by others outside your company. For example, where will the money come from to start your business?”

Photo: Eclipse Studios/McGraw-Hill;
Photo: Jill Braaten/McGraw-Hill
Education

YOU SHOULD KNOW

Financial Statements: Reports that summarize the financial results of business activities.

“Ty and I will contribute \$5,000 each from personal savings. But I’ll still need to ask the bank for a \$20,000 loan to buy computer equipment and software. What will the bank want to know?”



Laurie described **financial accounting reports**, called **financial statements**, which are prepared periodically to provide information to people not employed by the business. These external financial statement users aren't given access to detailed internal records of

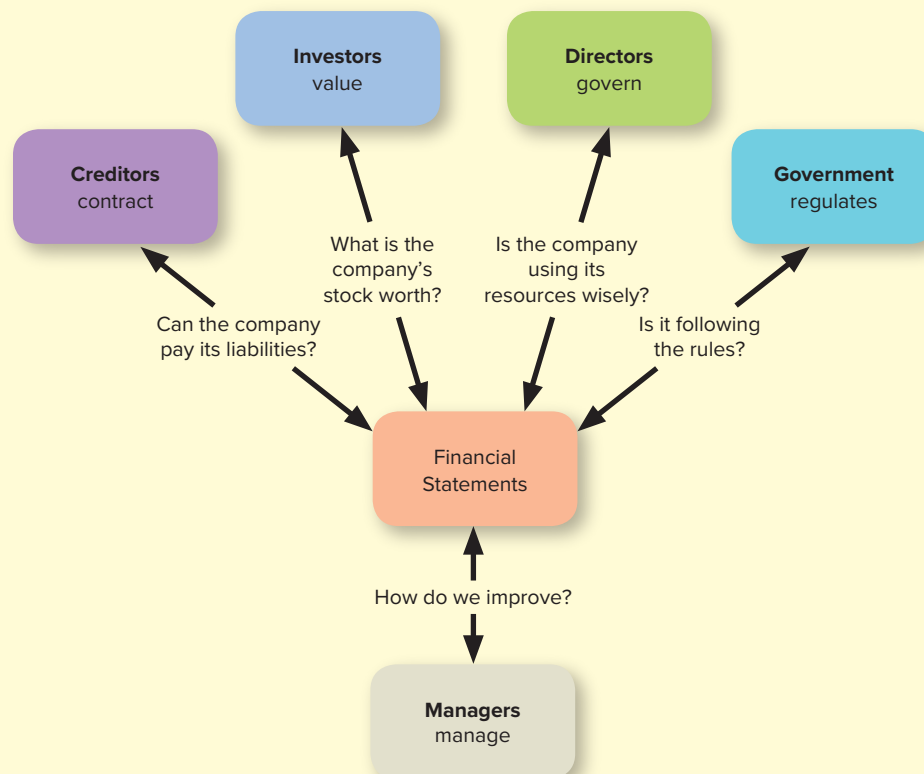
the company, so they rely extensively on the financial statements. The four main groups of external users are (1) creditors, (2) investors, (3) directors, and (4) government.

1. **Creditors** include suppliers, banks, and anyone to whom money is owed. *Suppliers* want to be sure they will be paid for the goods and services they deliver, so they will evaluate a company's financial statements and check its credit history before allowing it to buy on credit. *Banks* use financial statements to evaluate the risk they will not be repaid the money they've loaned to a company. Because banks take a risk when they loan money to a company, they want periodic financial reports to evaluate how well the company is doing so they can intervene if it looks like the company will have trouble repaying its loan.
2. **Investors** include existing and potential stockholders. *Stockholders* look to accounting information to assess the financial strength of a business and, ultimately, to estimate its value.
3. **Directors** is the short title for the members of a company's *board of directors*. The stockholders of public companies or large private companies elect directors to oversee the company's managers. Directors use financial statements to ensure the company's managers make decisions that are in the best financial interests of its stockholders.
4. **Government** agencies look closely at companies' financial statements. The *Securities and Exchange Commission (SEC)*, for example, is responsible for the functioning of stock markets, so it keeps a close watch on the information public companies report in financial statements. Also, the *Internal Revenue Service (IRS)* and state and local governments use financial statement information to ensure taxes are computed using correct amounts.

Exhibit 1.2 shows that, along with managers inside the company, these external user groups are key users of financial statement information. In Noodlecake's case, the bank will be the

EXHIBIT 1.2

External and Internal Users and Uses of Financial Statements



main external user. Jordan will be expected to prepare financial statements to obtain a bank loan and then regularly provide updated financial reports until the loan is repaid.

While Jordan understood everything Laurie had told him up to this point, he had another major concern.

“I want to sound intelligent when I talk to my banker, but I don’t know much about accounting.”



“This is a common concern for new business owners, so let’s start with the most basic thing you need to know about accounting.”

Photo: Eclipse Studios/McGraw-Hill;
Photo: Jill Braaten/McGraw-Hill
Education

Study the Accounting Methods

Learning Objective 1-2

Describe the purpose, structure, and content of the four basic financial statements.

THE BASIC ACCOUNTING EQUATION

One of the central concepts to understanding financial reports is that **what a company owns must equal what a company owes to its creditors and stockholders**. In accounting, there are special names for the items a company owns (assets) and the claims on these items by creditors (liabilities) and stockholders (equity), as shown below.

Resources Owned . . .	=	Resources Owed . . .	
by the company		to creditors	to stockholders
Assets	=	Liabilities	+ Stockholders' Equity

The relationship between assets (A), liabilities (L), and stockholders' equity (SE) is known as the **basic accounting equation**. The business itself, not the stockholders who own the business, is viewed as owning the assets and owing the liabilities. This separation between stockholders and business is called the **separate entity assumption**, which requires that a business's financial reports include only the activities of the business and not the personal dealings of its stockholders.

The elements of the basic accounting equation are fundamental to reading and understanding financial statements, so let's look at each in detail.

Assets

An **asset** is a resource the company controls and expects to benefit from in the future. For **Noodlecake**, assets include things like cash, supplies, equipment, buildings, and software. Other companies, such as **Nike** and **Target**, also have an asset called inventory, which consists of merchandise held for sale.

Liabilities

Liabilities are measurable amounts the company expects to give up in the future to settle what it presently owes to creditors. If **Noodlecake** borrows \$20,000 from a bank, it would owe a \$20,000 liability called Notes Payable. This particular name is used because banks require borrowers to sign a legal document called a *note* that describes the company's promise to

YOU SHOULD KNOW

Basic Accounting Equation:

Assets = Liabilities + Stockholders' Equity.

Separate Entity Assumption:

States that business transactions are separate from and should exclude the personal transactions of the owners.

repay the bank. If Noodlecake receives paper, pens, and toner bought on credit from suppliers, it would owe a liability called Accounts Payable. This particular name is used because purchases made using credit are said to be “on account.” Noodlecake could also owe salaries and wages to employees (Salaries and Wages Payable) and taxes to governments (Taxes Payable).

Stockholders’ Equity

Stockholders’ equity represents the owners’ claims on assets of the business after creditors’ claims have been fulfilled. From a legal perspective, creditors have priority over stockholders. Thus, if a company goes out of business, liabilities must be paid before any amounts are paid to stockholders. Owners’ claims arise from two sources.

1. **Paid-in capital.** The owners have a claim for amounts they contributed directly to the company in exchange for its stock (Common Stock).
2. **Earned capital.** The owners have a claim on profits the company has earned for them through its business operations (Retained Earnings).

The second item listed above is particularly important because a business can survive only if it is profitable. It will be profitable if the total amount earned from selling goods and services is greater than the costs incurred to generate those sales. Theoretically, these profits belong to the company’s owners, so they increase stockholders’ equity. Through these profits, owners can get more money back from the company than they paid in (a return on their investment).

Given the importance of a company’s profits, accounting systems separately track the two components of profit: revenues and expenses.

Revenues Revenues are earned by selling goods or services to customers. For **Noodlecake**, revenues are measured at the amount the company charges customers for its apps.

Expenses Expenses are all costs of doing business that are necessary to earn revenues. Noodlecake incurs expenses for advertising, utilities, rent, salaries and wages, insurance, and supplies used up in the office. Notice that expenses are said to be “incurred” to generate revenues. The word *incurred* means the activities giving rise to a cost (e.g., running an ad, using electricity) have occurred in the period in which the related revenues have been generated.

Net Income Although *profit* is used in casual conversation, the preferred term in accounting is *net income*. Net income is calculated as revenues minus expenses. For Noodlecake to be profitable, its revenues must be greater than its expenses. (If revenues are less than expenses, the company would have a net loss, but for now we’ll assume Noodlecake is going to earn a profit.) **By generating net income, a company increases its stockholders’ equity**, as illustrated below. This net income can be left in the company to accumulate (with earnings that have been retained from prior years), or it can be paid out to the company’s stockholders for their own personal use (called *dividends*).

