# Principles of Accounting, Volume 1: Financial Accounting

#### SENIOR CONTRIBUTING AUTHORS

MITCHELL FRANKLIN, LE MOYNE COLLEGE (FINANCIAL ACCOUNTING)

PATTY GRAYBEAL, UNIVERSITY OF MICHIGAN-DEARBORN (MANAGERIAL ACCOUNTING)

DIXON COOPER, OUACHITA BAPTIST UNIVERSITY

#### **TABLE OF CONTENTS**

#### Preface 1

 $\equiv$ 

1 Role of Accounting in Society
---------------------------------

- **1.1** Explain the Importance of Accounting and Distinguish between Financial and Managerial Accounting 12
- **1.2** Identify Users of Accounting Information and How They Apply Information 14
- 1.3 Describe Typical Accounting Activities and the Role Accountants Play in Identifying,Recording, and Reporting Financial Activities 18
- **1.4** Explain Why Accounting Is Important to Business Stakeholders 24
- **1.5** Describe the Varied Career Paths Open to Individuals with an Accounting Education 32

#### 2 Introduction to Financial Statements 61

- 2.1 Describe the Income Statement, Statement of Owner's Equity, Balance Sheet, andStatement of Cash Flows, and How They Interrelate62
- 2.2 Define, Explain, and Provide Examples of Current and Noncurrent Assets, Current and Noncurrent Liabilities, Equity, Revenues, and Expenses 77
- 2.3 Prepare an Income Statement, Statement of Owner's Equity, and Balance Sheet 81

### 3 Analyzing and Recording Transactions 115

- **3.1** Describe Principles, Assumptions, and Concepts of Accounting and Their Relationship to Financial Statements 116
- **3.2** Define and Describe the Expanded Accounting Equation and Its Relationship to Analyzing Transactions 124
- **3.3** Define and Describe the Initial Steps in the Accounting Cycle 130
- **3.4** Analyze Business Transactions Using the Accounting Equation and Show the Impact of Business Transactions on Financial Statements 135
- 3.5 Use Journal Entries to Record Transactions and Post to T-Accounts 140
- **3.6** Prepare a Trial Balance 165

#### 4 The Adjustment Process 211

- **4.1** Explain the Concepts and Guidelines Affecting Adjusting Entries 212
- **4.2** Discuss the Adjustment Process and Illustrate Common Types of Adjusting Entries 215
- **4.3** Record and Post the Common Types of Adjusting Entries 227
- **4.4** Use the Ledger Balances to Prepare an Adjusted Trial Balance 236
- 4.5 Prepare Financial Statements Using the Adjusted Trial Balance 239

#### 5 Completing the Accounting Cycle 285

- **5.1** Describe and Prepare Closing Entries for a Business 286
- **5.2** Prepare a Post-Closing Trial Balance 298

- **5.3** Apply the Results from the Adjusted Trial Balance to Compute Current Ratio and Working Capital Balance, and Explain How These Measures Represent Liquidity 300
- **5.4** Appendix: Complete a Comprehensive Accounting Cycle for a Business 313

### 6 Merchandising Transactions 365

- **6.1** Compare and Contrast Merchandising versus Service Activities and Transactions 366
- **6.2** Compare and Contrast Perpetual versus Periodic Inventory Systems 378
- **6.3** Analyze and Record Transactions for Merchandise Purchases Using the Perpetual Inventory System 386
- **6.4** Analyze and Record Transactions for the Sale of Merchandise Using the Perpetual Inventory System 392
- **6.5** Discuss and Record Transactions Applying the Two Commonly Used Freight-In Methods 400
- **6.6** Describe and Prepare Multi-Step and Simple Income Statements for Merchandising Companies 404
- **6.7** Appendix: Analyze and Record Transactions for Merchandise Purchases and Sales Using the Periodic Inventory System 408

### 7 Accounting Information Systems 451

- **7.1** Define and Describe the Components of an Accounting Information System 452
- **7.2** Describe and Explain the Purpose of Special Journals and Their Importance to Stakeholders 466
- **7.3** Analyze and Journalize Transactions Using Special Journals 476
- 7.4 Prepare a Subsidiary Ledger 487
- 7.5 Describe Career Paths Open to Individuals with a Joint Education in Accounting and Information Systems 494

#### 8 Fraud, Internal Controls, and Cash 531

- **8.1** Analyze Fraud in the Accounting Workplace 532
- **8.2** Define and Explain Internal Controls and Their Purpose within an Organization 535
- **8.3** Describe Internal Controls within an Organization 542
- **8.4** Define the Purpose and Use of a Petty Cash Fund, and Prepare Petty Cash Journal Entries 547
- **8.5** Discuss Management Responsibilities for Maintaining Internal Controls within an Organization 551
- **8.6** Define the Purpose of a Bank Reconciliation, and Prepare a Bank Reconciliation and Its Associated Journal Entries 552
- **8.7** Describe Fraud in Financial Statements and Sarbanes-Oxley Act Requirements 55

## 9 Accounting for Receivables 577

- **9.1** Explain the Revenue Recognition Principle and How It Relates to Current and Future Sales and Purchase Transactions 578
- **9.2** Account for Uncollectible Accounts Using the Balance Sheet and Income Statement Approaches 584

- **9.3** Determine the Efficiency of Receivables Management Using Financial Ratios 594
- **9.4** Discuss the Role of Accounting for Receivables in Earnings Management 599
- 9.5 Apply Revenue Recognition Principles to Long-Term Projects 603
- **9.6** Explain How Notes Receivable and Accounts Receivable Differ 606
- **9.7** Appendix: Comprehensive Example of Bad Debt Estimation 612

#### 10 Inventory 647

- 10.1 Describe and Demonstrate the Basic Inventory Valuation Methods and Their Cost Flow Assumptions 648
- **10.2** Calculate the Cost of Goods Sold and Ending Inventory Using the Periodic Method 657
- **10.3** Calculate the Cost of Goods Sold and Ending Inventory Using the Perpetual Method 663
- **10.4** Explain and Demonstrate the Impact of Inventory Valuation Errors on the Income Statement and Balance Sheet 672
- **10.5** Examine the Efficiency of Inventory Management Using Financial Ratios 674

#### 11 Long-Term Assets 699

- **11.1** Distinguish between Tangible and Intangible Assets 700
- 11.2 Analyze and Classify Capitalized Costs versus Expenses 704
- **11.3** Explain and Apply Depreciation Methods to Allocate Capitalized Costs 709
- **11.4** Describe Accounting for Intangible Assets and Record Related Transactions 721
- **11.5** Describe Some Special Issues in Accounting for Long-Term Assets 723

### 12 Current Liabilities 745

- **12.1** Identify and Describe Current Liabilities 746
- **12.2** Analyze, Journalize, and Report Current Liabilities 755
- **12.3** Define and Apply Accounting Treatment for Contingent Liabilities 764
- **12.4** Prepare Journal Entries to Record Short-Term Notes Payable 773
- **12.5** Record Transactions Incurred in Preparing Payroll 777

#### 13 Long-Term Liabilities 809

- **13.1** Explain the Pricing of Long-Term Liabilities 810
- **13.2** Compute Amortization of Long-Term Liabilities Using the Effective-Interest Method 822
- **13.3** Prepare Journal Entries to Reflect the Life Cycle of Bonds 830
- **13.4** Appendix: Special Topics Related to Long-Term Liabilities 842

#### 14 Corporation Accounting 859

- **14.1** Explain the Process of Securing Equity Financing through the Issuance of Stock 860
- **14.2** Analyze and Record Transactions for the Issuance and Repurchase of Stock 871
- **14.3** Record Transactions and the Effects on Financial Statements for Cash Dividends, Property Dividends, Stock Dividends, and Stock Splits 879

- **14.4** Compare and Contrast Owners' Equity versus Retained Earnings 890
- **14.5** Discuss the Applicability of Earnings per Share as a Method to Measure Performance 897

### 15 Partnership Accounting 925

- **15.1** Describe the Advantages and Disadvantages of Organizing as a Partnership 926
- **15.2** Describe How a Partnership Is Created, Including the Associated Journal Entries 932
- **15.3** Compute and Allocate Partners' Share of Income and Loss 935
- **15.4** Prepare Journal Entries to Record the Admission and Withdrawal of a Partner 938
- **15.5** Discuss and Record Entries for the Dissolution of a Partnership 943

#### 16 Statement of Cash Flows 955

- **16.1** Explain the Purpose of the Statement of Cash Flows 956
- **16.2** Differentiate between Operating, Investing, and Financing Activities 957
- **16.3** Prepare the Statement of Cash Flows Using the Indirect Method 959
- **16.4** Prepare the Completed Statement of Cash Flows Using the Indirect Method 971
- **16.5** Use Information from the Statement of Cash Flows to Prepare Ratios to Assess Liquidity and Solvency 974
- **16.6** Appendix: Prepare a Completed Statement of Cash Flows Using the Direct Method 979
- A Financial Statement Analysis 1009
- **B** Time Value of Money 1021
- C Suggested Resources 1025

**Index 1041**