

FOURTH EDITION

CORNERSTONES OF FINANCIAL ACCOUNTING

Jay S. Rich

Illinois State University

Jefferson P. Jones

Auburn University



Australia • Brazil • Mexico • Singapore • United Kingdom • United States



BRIEF CONTENTS

CHAPTER 1	Accounting and the Financial Statements	2
CHAPTER 2	The Accounting Information System	58
CHAPTER 3	Accrual Accounting	120
	MAKING THE CONNECTION	186
CHAPTER 4	Internal Control and Cash	188
CHAPTER 5	Sales and Receivables	236
CHAPTER 6	Cost of Goods Sold and Inventory	288
CHAPTER 7	Operating Assets	362
	MAKING THE CONNECTION	422
CHAPTER 8	Current and Contingent Liabilities	424
CHAPTER 9	Long-Term Liabilities	468
CHAPTER 10	Stockholders' Equity	524
	MAKING THE CONNECTION	578
CHAPTER 11	The Statement of Cash Flows	580
CHAPTER 12	Financial Statement Analysis	646
APPENDIX 1	International Financial Reporting Standards	728
APPENDIX 2	Investments	742
APPENDIX 3	Time Value of Money	762
APPENDIX 4	Financial Statement Information: Under Armour	787
APPENDIX 5	Financial Statement Information: Columbia Sportswear	796
Glossary		804
Check Figures		814
Index		820



CONTENTS

CHAPTER 1

Accounting and the Financial Statements 2

What Is Accounting? 4

Exhibit 1.1 The Demand for Accounting Information and Typical Questions 4

Businesses: Forms and Activities 5

Forms of Business Organization 5

Exhibit 1.2 Forms of Business Organization 6

Business Activities 6

Exhibit 1.3 Business Activities 6

Communication of Accounting Information 8

Exhibit 1.4 Questions Answered by Financial Statements 8

The Four Basic Financial Statements 8

Exhibit 1.5 Financial Statement Time Periods 9

The Fundamental Accounting Equation 10

Cornerstone 1.1 Using the Fundamental Accounting Equation 10

The Classified Balance Sheet 11

Exhibit 1.6 Common Balance Sheet Classifications 11

Current Assets 12

Exhibit 1.7 Classified Balance Sheet of Apple Inc. 12

Noncurrent Assets 13

Current Liabilities 14

Long-Term Liabilities and Stockholders' Equity 14

Cornerstone 1.2 Preparing a Classified Balance Sheet Using Balance Sheet Information 15

The Income Statement 17

Elements of the Income Statement 17

Exhibit 1.8 Income Statement of Apple Inc. 17

Preparing an Income Statement 18

Cornerstone 1.3 Preparing an Income Statement 19

Income Statement Formats 19

Exhibit 1.9 Multiple-Step Income Statement for Apple Inc. 20

Exhibit 1.10 Typical Nonoperating Items 21

Using Income Statement Information 21

Retained Earnings Statement 22

Exhibit 1.11 Retained Earnings Statement for Apple Inc. 22

Cornerstone 1.4 Preparing a Retained Earnings Statement 23

Use of the Retained Earnings Statement 23

Statement of Cash Flows 24

Exhibit 1.12 Statement of Cash Flows 24

Elements of the Statement of Cash Flows 24

Use of the Statement of Cash Flows 25

Relationships Among the Statements 25

Other Items in the Annual Report and Professional Ethics 25

Notes to the Financial Statements 25

Exhibit 1.13 Relationships Among the Financial Statements 26

Management's Discussion and Analysis 27

Report of Independent Accountants 27

Exhibit 1.14 Auditor's Report for Apple Inc. 28

Professional Ethics 29

Exhibit 1.15 Guidelines in Ethical Decision Making 29

CHAPTER 2

The Accounting Information System 58

Fundamental Accounting Concepts 60

The Conceptual Framework 60

Qualitative Characteristics of Useful Information 60

Exhibit 2.1 Qualitative Characteristics of Useful Information 61

Exhibit 2.2 Qualitative Characteristics of Accounting Information 62

Assumptions 62

Principles 63

Cornerstone 2.1 Applying the Conceptual Framework 63

Measuring Business Activities: The Accounting Cycle 65

Exhibit 2.3 The Accounting Cycle 65

Economic Events 65

Exhibit 2.4 Transaction Identification 66

The Expanded Accounting Equation 66

Exhibit 2.5 The Expanded Accounting Equation 67

Step 1: Analyze Transactions 67

Cornerstone 2.2 Performing Transaction Analysis 68

Overview of Transactions for HiTech Communications Inc. 72

Exhibit 2.6 Summary of Transactions for HiTech Communications Inc. 73

Double-Entry Accounting 73

Accounts 74

Exhibit 2.7 Typical Accounts 74

Exhibit 2.8 Form of a T-Account 74

Debit and Credit Procedures 75

Cornerstone 2.3 Determining Increases or Decreases to a Balance Sheet Account 75

Exhibit 2.9 Normal Balances of Contributed Capital (e.g., Common Stock) and Retained Earnings 76

Cornerstone 2.4 Determining Increases or Decreases to Revenues, Expenses, and Dividends 77

<i>Exhibit 2.10 Summary of Debit and Credit Procedures</i>	78	<i>Exhibit 3.13 General Ledger of HiTech Communications</i>	139
Step 2: Journalize Transactions	79	Step 6: Preparing the Financial Statements	140
Cornerstone 2.5 Making a Journal Entry	79	<i>Exhibit 3.14 Adjusted Trial Balance</i>	141
Step 3: Post to the Ledger	83	<i>Exhibit 3.15 Relationships Among the Financial Statements</i>	142
<i>Exhibit 2.11 The Posting Process for HiTech Communications Inc.</i>	84	Step 7: Closing the Accounts	143
<i>Exhibit 2.12 General Ledger Accounts of HiTech Communications (T-account view)</i>	85	Cornerstone 3.7 Closing the Accounts	143
Step 4: Prepare a Trial Balance	85	<i>Exhibit 3.16 The Closing Process</i>	145
Cornerstone 2.6 Preparing a Trial Balance	86	Summary of the Accounting Cycle	145
		<i>Exhibit 3.17 The Accounting Cycle</i>	145
CHAPTER 3		Appendix 3A: Using a Worksheet to Prepare Financial Statements	146
Accrual Accounting	120	<i>Exhibit 3.18 Worksheet</i>	147
<i>Exhibit 3.1 Excerpt from FedEx's Financial Statements</i>	121	<i>Exhibit 3.19 Kenny's Laundry Adjusted Account Balances</i>	153
Completing the Accounting Cycle	122	<i>Exhibit 3.20 Financial Statements for Kenny's Laundry</i>	154
<i>Accrual versus Cash Basis of Accounting</i>	122	MAKING THE CONNECTION	186
Key Elements of Accrual Accounting	122		
<i>Exhibit 3.2 Key Elements of Accrual Accounting Time-Period Assumption</i>	123	CHAPTER 4	
<i>The Revenue Recognition Principle</i>	123	Internal Control and Cash	188
<i>Exhibit 3.3 Annual Report Excerpt: FedEx's Revenue Recognition Policy</i>	124		
<i>The Expense Recognition Principle</i>	124	Role of Internal Control	190
<i>Exhibit 3.4 Instances of Accounting Abuses Applying the Principles</i>	125	<i>Exhibit 4.1 Relationship of Objectives, the Entity, and the Components of Internal Control</i>	190
Cornerstone 3.1 Applying the Revenue Recognition and Expense Recognition Principles	125	<i>Exhibit 4.2 Section 302 Certification by Kevin Plank (CEO of Under Armour) Taken from SEC Filings (Exhibit 31.01 of 10-K) for the Year Ended December 31, 2016</i>	191
Accrual Accounting and Adjusting Entries	126	Components of Internal Control	192
<i>Which Transactions Require Adjustment?</i>	126	<i>Control Environment and Ethical Behavior</i>	192
Cornerstone 3.2 Determining Which Transactions Require Adjustment	127	<i>Risk Assessment</i>	193
Step 5: Adjusting the Accounts	128	<i>Control Activities</i>	194
<i>Exhibit 3.5 Types of Adjusting Entries</i>	128	<i>Information and Communication</i>	195
<i>Accrued Revenues</i>	128	<i>Monitoring</i>	195
<i>Exhibit 3.6 Accrued Revenues</i>	129	<i>Relationship between Control Activities and the Accounting System</i>	195
Cornerstone 3.3 Recording Accrued Revenues	129	<i>Exhibit 4.3 Relationship between the Accounting System and Control Procedures</i>	196
<i>Accrued Expenses</i>	130	Accounting and Reporting Cash	197
<i>Exhibit 3.7 Accrued Expenses</i>	130	<i>Exhibit 4.4 Balance Sheet Reporting of Cash for Under Armour, Inc.</i>	197
Cornerstone 3.4 Recording Accrued Expenses	131	Cash Controls	197
<i>Deferred (Unearned) Revenues</i>	132	<i>Reconciliation of Accounting Records to Bank Statement</i>	199
<i>Exhibit 3.8 Deferred (Unearned) Revenues</i>	132	<i>Exhibit 4.5 Bank Statement</i>	200
Cornerstone 3.5 Adjusting Deferred (Unearned) Revenues	132	<i>Exhibit 4.6 T-Account for Cash, Prior to Reconciliation</i>	201
<i>Deferred (Prepaid) Expenses</i>	133	Cornerstone 4.1 Performing a Bank Reconciliation	202
<i>Exhibit 3.9 Deferred (Prepaid) Expenses</i>	134	Cornerstone 4.2 Making Adjusting Entries as a Result of the Bank Reconciliation	203
Cornerstone 3.6 Adjusting Deferred (Prepaid) Expenses	134	<i>Cash Over and Short</i>	204
<i>Exhibit 3.10 Financial Statement Presentation of Accumulated Depreciation</i>	136	Cornerstone 4.3 Recording Cash Over and Short	204
<i>Summary of Financial Statement Effects of Adjusting Entries</i>	136	<i>Petty Cash</i>	205
<i>Exhibit 3.11 Effects of Adjusting Entries on the Financial Statements</i>	136	Cornerstone 4.4 Accounting for Petty Cash	206
<i>Exhibit 3.12 Trial Balance</i>	137	Operating Cycle	207
<i>Comprehensive Example</i>	137	<i>Exhibit 4.7 The Operating Cycle</i>	207
		<i>Cash Management</i>	208

<i>Buying Inventory</i>	208	<i>Exhibit 6.5 Cost of Goods Sold Model</i>	293
<i>Paying for Inventory</i>	208	Cornerstone 6.1 Applying the Cost of Goods Sold Model	293
<i>Selling Inventory</i>	208	<i>Inventory Systems</i>	294
<i>Short-Term Investments</i>	208	Recording Inventory Transactions—Perpetual System	296
CHAPTER 5		<i>Accounting for Purchases of Inventory</i>	296
Sales and Receivables	236	<i>Exhibit 6.6 Sample Invoice</i>	297
Timing of Revenue Recognition	238	<i>Exhibit 6.7 Shipping Terms</i>	298
Amount of Revenue Recognized	238	Cornerstone 6.2 Recording Purchase Transactions in a Perpetual Inventory System	299
<i>Sales Discounts</i>	238	<i>Exhibit 6.8 Calculation of Net Purchases</i>	300
Cornerstone 5.1 Recording Receivables Using the Net Method	239	<i>Accounting for Sales of Inventory</i>	301
<i>Sales Returns and Allowances</i>	240	Cornerstone 6.3 Recording Sales Transactions in a Perpetual Inventory System	301
Types of Receivables	241	Costing Inventory	303
Accounting for Bad Debts	241	<i>Inventory Costing Methods</i>	303
<i>Direct Write-Off Method</i>	242	<i>Exhibit 6.9 Use of Inventory Costing Methods</i>	304
<i>Allowance Method</i>	242	<i>Exhibit 6.10 Allocation of Inventory Costs</i>	305
Cornerstone 5.2 Estimating Bad Debt Expense Using the Percentage of Credit Sales Method	243	<i>Specific Identification</i>	305
Cornerstone 5.3 Estimating the Allowance for Doubtful Accounts Using the Aging Method	245	Cornerstone 6.4 Applying the Specific Identification Method	305
<i>Bad Debts from a Management Perspective</i>	247	<i>First-In, First-Out (FIFO)</i>	307
Cash Management Principles Related to Accounts Receivable	247	Cornerstone 6.5 Applying the FIFO Inventory Costing Method	307
<i>Factoring Receivables</i>	248	<i>Last-In, First-Out (LIFO)</i>	308
<i>Credit Cards</i>	248	Cornerstone 6.6 Applying the LIFO Inventory Costing Method	309
<i>Debit Cards</i>	249	<i>Average Cost</i>	310
Notes Receivable	249	Cornerstone 6.7 Applying the Average Cost Inventory Costing Method	310
<i>Exhibit 5.1 Principal and Interest in Loan Repayments</i>	249	Analysis of Inventory Costing Methods	312
Cornerstone 5.4 Accounting for Notes Receivable	250	<i>Illustrating Relationships: Financial Statement Effects of Alternative Costing Methods</i>	312
Internal Control for Sales	251	<i>Exhibit 6.11 Financial Statement Effects of Alternative Inventory Costing Methods</i>	312
<i>Exhibit 5.2 Internal Controls for Recording Sales Revenue</i>	252	<i>Exhibit 6.12 Financial Statement Effects of Alternative Inventory Costing Methods</i>	313
Analyzing Sales and Receivables	252	<i>Income Tax Effects of Alternative Costing Methods</i>	313
<i>Sales</i>	252	<i>Consistency in Application</i>	314
<i>Receivables</i>	253	Lower of Cost or Market Rule	314
Cornerstone 5.5 Calculating the Gross Profit Margin, Operating Margin, Net Profit Margin, and Accounts Receivable Turnover Ratios	254	Cornerstone 6.8 Valuing Inventory at Lower of Cost or Market	315
Appendix 5A: Recording Receivables Using the Gross Method	255	Analyzing Inventory	316
CHAPTER 6		Cornerstone 6.9 Calculating the Gross Profit and Inventory Turnover Ratios	317
Cost of Goods Sold and Inventory	288	<i>LIFO Reserve Adjustments</i>	318
<i>Exhibit 6.1 Composition of Wal-Mart's Current Assets</i>	289	<i>Exhibit 6.13 LIFO Reserve Disclosure</i>	319
Nature of Inventory and Cost of Goods Sold	290	Effects of Inventory Errors	319
<i>Exhibit 6.2 Relative Composition of Inventory for Different Companies</i>	290	<i>Exhibit 6.14 Effect of an Inventory Error</i>	320
<i>Types of Inventory and Flow of Costs</i>	291	Cornerstone 6.10 Analyzing Inventory Errors	321
<i>Exhibit 6.3 Inventory Disclosure of Intel</i>	292	Appendix 6A: Periodic Inventory System	321
<i>Cost of Goods Sold Model</i>	292	Cornerstone 6.11 Recording Purchase Transactions in a Periodic Inventory System	322
<i>Exhibit 6.4 Flow of Inventory Costs</i>	292	<i>Exhibit 6.15 Perpetual versus Periodic Inventory Systems</i>	323
		Appendix 6B: Inventory Costing Methods and the Periodic Inventory System	323
		<i>First-In, First-Out (FIFO)</i>	324

Cornerstone 6.12 Applying the FIFO Inventory Costing Method in a Periodic Inventory System	324	Cornerstone 7.7 Analyzing Fixed Asset Ratios	385
<i>Last-In, First-Out (LIFO)</i>	325	Intangible Assets	387
Cornerstone 6.13 Applying the LIFO Inventory Costing Method in a Periodic Inventory System	325	<i>Accounting for Intangible Assets</i>	387
<i>Average Cost Method</i>	326	<i>Exhibit 7.12 Common Types of Intangible Assets</i>	388
Cornerstone 6.14 Applying the Average Cost Inventory Costing Method in a Periodic Inventory System	326	Cornerstone 7.8 Accounting for Intangible Assets	388
CHAPTER 7		Natural Resources	390
Operating Assets	362	Cornerstone 7.9 Accounting for Depletion of a Natural Resource	390
Understanding Operating Assets	364	<i>Exhibit 7.13 Disclosure of Natural Resource by Miller Mining Company</i>	392
<i>Exhibit 7.1 Percentages of Operating Assets in Relation to Total Assets</i>	364	Appendix 7A: Impairment of Property, Plant, and Equipment	392
Acquisition of Property, Plant, and Equipment	365	Cornerstone 7.10 Recording an Impairment of Property, Plant, and Equipment	392
<i>Measuring the Cost of a Fixed Asset</i>	365	MAKING THE CONNECTION	422
<i>Exhibit 7.2 Typical Costs of Acquiring Property, Plant, and Equipment</i>	366	CHAPTER 8	
<i>Recording the Cost of a Fixed Asset</i>	366	Current and Contingent Liabilities	424
Cornerstone 7.1 Measuring and Recording the Cost of a Fixed Asset	367	Current and Contingent Liabilities	426
Depreciation	368	Recognition and Measurement of Liabilities	426
<i>Exhibit 7.3 Excerpt from Verizon's 2016 Annual Report Information Required for Measuring Depreciation</i>	369	<i>Exhibit 8.1 Characteristics of Liabilities</i>	427
<i>Exhibit 7.4 Components of Depreciation Expense</i>	369	<i>Recognition of Liabilities</i>	427
<i>Exhibit 7.5 Excerpt from Verizon's 2016 Annual Report</i>	370	<i>Measurement of Liabilities</i>	427
Depreciation Methods	371	Current Liabilities	428
<i>Straight-Line Method</i>	371	<i>Exhibit 8.2 Current Liability Sections from Two Balance Sheets</i>	428
<i>Exhibit 7.6 The Relative Use of Depreciation Methods</i>	371	<i>Accounts Payable</i>	429
Cornerstone 7.2 Computing Depreciation Expense Using the Straight-Line Method	372	<i>Accrued Liabilities</i>	429
<i>Exhibit 7.7 Straight-Line Pattern of Depreciation</i>	373	<i>Notes Payable</i>	430
<i>Declining Balance Method</i>	373	Cornerstone 8.1 Recording Notes Payable and Accrued Interest	430
Cornerstone 7.3 Computing Depreciation Expense Using the Declining Balance Method	374	<i>Exhibit 8.3 Effect of Borrowing Money on the Annual Income Statement and Balance Sheet</i>	431
<i>Exhibit 7.8 Declining Balance Pattern of Depreciation</i>	375	<i>Current Portion of Long-Term Debt</i>	433
<i>Units-of-Production Method</i>	376	<i>Other Payables</i>	433
Cornerstone 7.4 Computing Depreciation Expense Using the Units-of-Production Method	376	Cornerstone 8.2 Recording Liabilities at the Point of Sale	433
<i>Exhibit 7.9 Units-of-Production Pattern of Depreciation</i>	377	<i>Exhibit 8.4 Employer Payroll Taxes and Withheld Earnings</i>	435
<i>Choosing Between Depreciation Methods</i>	378	Cornerstone 8.3 Recording Payroll Taxes	435
<i>Exhibit 7.10 Depreciation Patterns over Time</i>	378	Cornerstone 8.4 Recording Unearned Revenues	437
<i>Depreciation for Partial Years</i>	379	Contingent Liabilities	438
<i>Depreciation and Income Taxes</i>	379	<i>Exhibit 8.5 Recognition of Contingent Liabilities</i>	438
Expenditures After Acquisition	380	Warranties	439
<i>Revenue Expenditures</i>	380	Cornerstone 8.5 Recording Warranty Liabilities	439
<i>Capital Expenditures</i>	380	Analyzing Current Liabilities	440
<i>Exhibit 7.11 Types of Expenditures</i>	381	Cornerstone 8.6 Calculating Liquidity Ratios	441
Revision of Depreciation	381	CHAPTER 9	
Cornerstone 7.5 Revising Depreciation Expense	381	Long-Term Liabilities	468
<i>Impairments</i>	382	<i>Exhibit 9.1 Excerpt from Whirlpool's 2016 10-K (Note 5)</i>	470
Disposal of Fixed Assets	382	Bonds Payable and Notes Payable	471
Cornerstone 7.6 Recording the Disposition of Property, Plant, and Equipment	383		
Analyzing Fixed Assets	385		

Types of Bonds	471	CHAPTER 10	
Exhibit 9.2 Long-Term Debt Terms	472	Stockholders' Equity	524
Selling New Debt Securities	472		
Exhibit 9.3 The Relationships between Stated Interest Rate and Yield	473	Exhibit 10.1 Elements of Stockholders' Equity	526
Accounting for Long-Term Debt	474	Raising Capital within a Corporation	526
Exhibit 9.4 Cash Flows for a Bond	474	Authorization to Issue Stock	526
Recording Issuance	474	Exhibit 10.2 Determination of Share Quantities	527
Exhibit 9.5 Balance Sheet Presentation	474	Common Stock	527
Cornerstone 9.1 Recording the Issuance of Bonds	475	Preferred Stock	528
		Comparison of Common and Preferred Stock	528
Recognizing Interest Expense and Repayment of Principal	475	Accounting for Issuance of Common and Preferred Stock	529
Interest Amortization Methods	476	Cornerstone 10.1 Recording the Sale of Common and Preferred Stock	530
The Straight-Line Method	476	Stated Capital and No-Par Stock	531
Debt with Regular Interest Payments Sold at Par	476	Warrants	531
Cornerstone 9.2 Recording Interest Expense for Bonds Sold at Par	476	Options	532
Debt with Regular Interest Payments Sold at a Premium or Discount	477	Accounting for Distributions to Stockholders	533
Cornerstone 9.3 Recording Interest Expense for Bonds Sold at a Discount Using the Straight-Line Method	478	Stock Repurchases (Treasury Stock)	533
Exhibit 9.6 Carrying Value over the Life of a Bond Issued at a Discount	479	Cornerstone 10.2 Accounting for Treasury Stock	534
Cornerstone 9.4 Recording Interest Expense for Bonds Sold at a Premium Using the Straight-Line Method	480	Dividends	536
Exhibit 9.7 Carrying Value over the Life of a Bond Issued at a Premium	481	Exhibit 10.3 Dividends	536
Accruing Interest	482	Cornerstone 10.3 Recording Cash Dividends	537
The Effective Interest Rate Method: Recognizing Interest Expense and Repayment of Principal	483	Cornerstone 10.4 Recording Small and Large Stock Dividends	538
Cornerstone 9.5 Recording Interest Expense for Bonds Sold at a Discount Using the Effective Interest Rate Method	484	Exhibit 10.4 Microsoft's Stock Price History	540
Cornerstone 9.6 Recording Interest Expense for Bonds Sold at a Premium Using the Effective Interest Rate Method	485	Cornerstone 10.5 Calculating Cumulative Preferred Dividends	541
Installment Debt	486	Accounting for Retained Earnings and Accumulated Other Comprehensive Income	543
Exhibit 9.8 Long-Term Debt Carrying Value Using Straight-Line and Effective Interest Methods to Amortize Premium and Discount	487	Restrictions on Retained Earnings	543
Pros and Cons of Debt Financing	487	Exhibit 10.5 Information from Deere & Co. 2016 10-K	544
Tax Deductible Interest Expense	487	Accounting for Accumulated Other Comprehensive Income	545
Leverage	488	Equity Analysis	545
Exhibit 9.9 Effects of Financing with Debt	488	Stockholder Profitability Ratios	546
Inflation	489	Cornerstone 10.6 Calculating Stockholder Profitability Ratios	546
Payment Schedule	489	Stockholder Payout	547
Leases	489	Cornerstone 10.7 Calculating Stockholder Payout Ratios	547
Ratio Analysis	490	Interpreting Ratios	548
Cornerstone 9.7 Calculating and Analyzing Long-Term Debt Ratios	491	MAKING THE CONNECTION	578
Appendix 9A: Pricing Long-Term Debt	493	CHAPTER 11	
Cornerstone 9.8 Determining the Market Value of a Bond	493	The Statement of Cash Flows	580
		Role of the Statement of Cash Flows	582
		Cash Flow Classifications	583
		Exhibit 11.1 How the Statement of Cash Flows Links the Two Balance Sheets	583
		Cash Flows from Operating Activities	583
		Cash Flows from Investing Activities	584
		Cash Flows from Financing Activities	584
		Noncash Investing and Financing Activities	585

<i>Exhibit 11.2 Classification of Cash Flows</i>	585	<i>Adjusting for Changes in Current Assets and Current Liabilities</i>	611
Cornerstone 11.1 Classifying Business Activities	586	<i>Exhibit 11.11 Spreadsheet to Prepare Statement of Cash Flows</i>	612
<i>Format of the Statement of Cash Flows</i>	587	<i>Adjusting for Cash Inflows and Outflows Associated with Financing Activities</i>	613
<i>Exhibit 11.3 Format of the Statement of Cash Flows</i>	587	<i>Completing the Statement of Cash Flows</i>	613
Analyzing the Accounts for Cash Flow Data	588		
Cornerstone 11.2 Classifying Changes in Balance Sheet Accounts	589		
<i>Exhibit 11.4 Cash Flow Classifications and Changes in Balance Sheet Accounts</i>	590		
Preparing a Statement of Cash Flows	590		
Preparing Cash Flows from Operating Activities	590	CHAPTER 12	
<i>Exhibit 11.5 Statement of Cash Flows for John Deere</i>	591	Financial Statement Analysis	646
<i>The Direct Method</i>	591	Use of Financial Statements in Decisions	648
<i>The Indirect Method</i>	592	<i>Customer Decisions</i>	648
<i>Exhibit 11.6 Use of the Indirect and Direct Methods</i>	592	<i>Exhibit 12.1 Users of Financial Statements and Typical Questions</i>	648
<i>Applying the Indirect Method</i>	592	<i>Supplier Decisions</i>	649
<i>Exhibit 11.7 Financial Statements for Brooke Sportswear</i>	593	<i>Employment Decisions</i>	649
Cornerstone 11.3 Calculating Net Cash Flow from Operating Activities: Indirect Method	594	<i>Credit Decisions</i>	649
<i>Exhibit 11.8 Adjustments Required to Calculate Cash Flow from Operating Activities</i>	595	<i>Investment Decisions</i>	649
Preparing Cash Flows from Investing Activities	598	SEC Filings	650
<i>Analyzing Investing Activities</i>	598	<i>Exhibit 12.2 The Most Important SEC Filings</i>	650
<i>Exhibit 11.9 Analyzing Investing Activities</i>	598	<i>Format and Content of Form 10-K</i>	651
Cornerstone 11.4 Reporting Net Cash Flow from Investing Activities	600	Analyzing Financial Statements with Cross Sectional and Time Series Analysis	652
Preparing Cash Flows from Financing Activities	600	<i>Cross Sectional Analysis</i>	652
<i>Analyzing Financing Activities</i>	600	<i>Time Series Analysis</i>	652
Cornerstone 11.5 Reporting Net Cash Flow from Financing Activities	602	<i>Cross Sectional and Time Series Analysis Illustrated</i>	653
<i>Exhibit 11.10 Statement of Cash Flows for Brooke Sportswear</i>	603	Cornerstone 12.1 Interpreting Cross Sectional and Time Series (or Trend) Analysis	653
Using the Statement of Cash Flows	603	Analyzing the Financial Statements with Horizontal and Vertical Analysis	654
<i>Examining the Statement of Cash Flows</i>	603	<i>Horizontal Analysis</i>	654
<i>Comparing the Statement of Cash Flows from Several Periods</i>	604	Cornerstone 12.2 Preparing Common Size Statements for Horizontal Analysis	654
Cornerstone 11.6 Analyzing Free Cash Flow and Cash Flow Adequacy	605	<i>Vertical Analysis</i>	656
<i>Comparing the Statement of Cash Flows to Similar Companies</i>	606	Cornerstone 12.3 Preparing Common Size Statements for Vertical Analysis	656
Appendix 11A: The Direct Method	606	Analyzing the Financial Statements with Ratio Analysis	659
<i>Cash Collected from Customers</i>	606	<i>Short-Term Liquidity Ratios</i>	659
<i>Other Cash Collections</i>	607	<i>Exhibit 12.3 Columbia Sportswear Income Statement and Balance Sheet</i>	662
<i>Cash Paid to Suppliers</i>	607	Cornerstone 12.4 Calculating and Interpreting Short-Term Liquidity Ratios	664
<i>Cash Paid for Operating Expenses</i>	607	<i>Debt Management Ratios</i>	664
<i>Cash Paid for Interest and Income Taxes</i>	608	Cornerstone 12.5 Calculating and Interpreting Debt Management Ratios	666
<i>Other Items</i>	609	<i>Asset Efficiency Ratios</i>	668
<i>Applying the Direct Method</i>	609	Cornerstone 12.6 Calculating and Interpreting Asset Efficiency Ratios	670
Cornerstone 11.7 Calculating Net Cash Flows from Operating Activities: Direct Method	610	<i>Profitability Ratios</i>	671
Appendix 11B: Using a Spreadsheet to Prepare the Statement of Cash Flows	610	Cornerstone 12.7 Calculating and Interpreting Profitability Ratios	673
<i>Net Income</i>	611	<i>Stockholder Ratios</i>	673
<i>Adjusting for Noncash Items</i>	611	Cornerstone 12.8 Calculating and Interpreting Stockholder Ratios	676
<i>Adjusting for Gains and/or Losses Due to Investing and Financing Activities</i>	611	<i>Dupont Analysis</i>	677

Cornerstone 12.9 Performing and Interpreting a Dupont Analysis	679		
Summary of Financial Ratios	679		
Exhibit 12.4 Summary of Financial Ratios	680		
Data for Ratio Comparisons	681		
APPENDIX 1			
International Financial Reporting Standards	728		
International Financial Reporting	729		
<i>What Are IFRS?</i>	729		
<i>Who Develops IFRS?</i>	729		
<i>Exhibit A1.1 Structure of the IASB</i>	730		
<i>How Long Has the IASB Been Issuing Standards?</i>	730		
<i>Exhibit A1.2 Key Dates in the Development of IFRS</i>	730		
<i>What Organizations Have Played a Role in the Development of IFRS?</i>	731		
<i>Who Uses IFRS?</i>	731		
<i>Exhibit A1.3 IFRS Around the World</i>	731		
<i>When Are IFRS Expected to Be Used in the United States?</i>	732		
<i>Exhibit A1.4 Should the SEC Require IFRS Adoption?</i>	732		
<i>What Are the Advantages of IFRS?</i>	732		
<i>Are There Potential Problems with Adopting IFRS?</i>	733		
<i>What Do Financial Statements Look Like Under IFRS?</i>	733		
<i>Exhibit A1.5 IFRS Implementation Challenges</i>	733		
<i>Exhibit A1.6 Financial Statements Prepared Under IFRS</i>	734		
Key Differences between IFRS and U.S. GAAP	736		
<i>How Will IFRS Impact My Study of Accounting?</i>	736		
<i>Exhibit A1.7 Effect of IFRS on Cornerstones of Financial Accounting (as of July 2012)</i>	736		
<i>Where Can I Go to Find Out More About IFRS?</i>	738		
APPENDIX 2			
Investments	742		
Overview of Accounting for Investments	743		
<i>Classifying and Accounting for Debt and Equity Securities</i>	744		
<i>Exhibit A2.1 Accounting for Investments in Debt and Equity Securities</i>	744		
<i>Amortized Cost Method</i>	745		
<i>Fair Value Method</i>	746		
<i>Exhibit A2.2 Investment Portfolio Data</i>	747		
<i>Equity Method</i>	749		
Consolidated Financial Statements	750		
<i>Preparing Consolidated Statements</i>	750		
<i>Exhibit A2.3 Worksheet for Preparing the Consolidated Balance Sheet on January 1, 2020</i>	751		
<i>Exhibit A2.4 Worksheet for Preparing the Consolidated Income Statement on December 31, 2020</i>	752		
<i>Reporting a Noncontrolling Interest</i>	752		
Business Combinations	752		
APPENDIX 3			
Time Value of Money	762		
Compound Interest Calculations	763		
Cornerstone A3.1 Computing Future Values Using Compound Interest	764		
Present Value of Future Cash Flows	765		
<i>Exhibit A3.1 Cash Flow Diagram</i>	765		
<i>Interest and the Frequency of Compounding</i>	766		
<i>Exhibit A3.2 Effect of Interest Periods on Compound Interest</i>	766		
Four Basic Compound Interest Problems	766		
<i>Computing the Future Value of a Single Amount</i>	766		
<i>Exhibit A3.3 Future Value of a Single Amount: An Example</i>	767		
Cornerstone A3.2 Computing Future Value of a Single Amount	768		
<i>Computing the Present Value of a Single Amount</i>	769		
<i>Exhibit A3.4 Present Value of a Single Amount: An Example</i>	769		
Cornerstone A3.3 Computing Present Value of a Single Amount	770		
<i>Computing the Future Value of an Annuity</i>	771		
<i>Exhibit A3.5 Future Value of an Annuity: An Example</i>	772		
Cornerstone A3.4 Computing Future Value of an Annuity	773		
<i>Present Value of an Annuity</i>	773		
<i>Exhibit A3.6 Present Value of An Annuity: An Example</i>	774		
Cornerstone A3.5 Computing Present Value of an Annuity	775		
<i>Exhibit A3.7 Future Value of a Single Amount</i>	783		
<i>Exhibit A3.8 Present Value of a Single Amount</i>	784		
<i>Exhibit A3.9 Future Value of an Annuity</i>	785		
<i>Exhibit A3.10 Present Value of an Annuity</i>	786		
APPENDIX 4			
Financial Statement Information: Under Armour	787		
APPENDIX 5			
Financial Statement Information: Columbia Sportswear	796		
Glossary	804		
Check Figures	814		
Index	820		