

# Fundamentals of FINANCIAL ACCOUNTING

Seventh Edition

**FRED PHILLIPS**

University of Saskatchewan

**SHANA CLOR-PROELL**

Texas Christian University

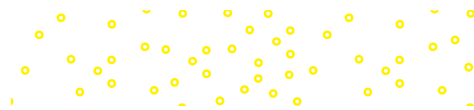
**ROBERT LIBBY**

Cornell University

**PATRICIA A. LIBBY**

Ithaca College

**Mc  
Graw  
Hill**





# Brief Contents

<b>CHAPTER 1</b>	2	<b>CHAPTER 11</b>	506
Business Decisions and Financial Accounting		Stockholders' Equity	
<b>CHAPTER 2</b>	46	<b>CHAPTER 12</b>	554
The Balance Sheet		Statement of Cash Flows	
<b>CHAPTER 3</b>	96	<b>CHAPTER 13</b>	612
The Income Statement		Measuring and Evaluating Financial Performance	
<b>CHAPTER 4</b>	150	<b>APPENDIX A</b>	A1
Adjustments, Financial Statements, and Financial Results		Excerpts from the Fiscal 2019 10-K Annual Report of The Home Depot, Inc.	
<b>CHAPTER 5</b>	212	<b>APPENDIX B</b>	B1
Fraud, Internal Control, and Cash		Excerpts from the Fiscal 2019 10-K Annual Report of Lowe's Companies, Inc.	
<b>CHAPTER 6</b>	258	<b>APPENDIX C</b>	C1
Merchandising Operations and the Multistep Income Statement		Present and Future Value Concepts	
<b>CHAPTER 7</b>	306	<b>APPENDIX D</b>	D1 (Available in Connect)
Inventory and Cost of Goods Sold		Investments in Other Corporations	
<b>CHAPTER 8</b>	350	<b>SOLUTIONS TO MULTIPLE-CHOICE QUESTIONS</b>	Q1
Receivables, Bad Debt Expense, and Interest Revenue		<b>CHART OF ACCOUNTS</b>	CA1
<b>CHAPTER 9</b>	394	<b>GLOSSARY</b>	G1
Long-Lived Tangible and Intangible Assets		<b>INDEXES</b>	IND1
<b>CHAPTER 10</b>	442		
Liabilities			

# Contents

## CHAPTER 1

Business Decisions and Financial Accounting 2

**NOODLECAKE STUDIOS, INC.** 3

---

Understand the Business 4

Organizational Forms 4

Accounting for Business Decisions 5

Study the Accounting Methods 8

The Basic Accounting Equation 8

Financial Statements 10

Evaluate the Results 17

Using Financial Statements 17

Useful Financial Information 17

Supplement: 1A Careers That Depend on Accounting Knowledge 20

Supplement: 1B Public Companies 21

[Review the Chapter](#) 23

[Practice Material](#) 27

## CHAPTER 2

The Balance Sheet 46

**NOODLECAKE STUDIOS, INC.** 47

---

Understand the Business 48

Building a Balance Sheet from Business Activities 48

Transactions and Other Activities 50

The Accounting Cycle 51

Step 1: Analyze Transactions 51

Steps 2 and 3: Record and Summarize 57

The Debit/Credit Framework 58

Preparing a Trial Balance and Balance Sheet 66

Evaluate the Results 67

Assessing the Ability to Pay 67

Balance Sheet Concepts and Values 68

Supplement: 2A Accounting Careers 70

[Review the Chapter](#) 71

[Practice Material](#) 75

## CHAPTER 3

The Income Statement 96

**NOODLECAKE STUDIOS, INC.** 97

---

Understand the Business 98

Operating Activities 98

Income Statement Accounts 99

Study the Accounting Methods 101

Cash Basis Accounting 101

Accrual Basis Accounting 102

The Expanded Accounting Equation 107

Unadjusted Trial Balance 114

Review of Revenues and Expenses 116

Evaluate the Results 117

Net Profit Margin 117

Income Statement Limitations 118

[Review the Chapter](#) 119

[Practice Material](#) 125

## CHAPTER 4

Adjustments, Financial Statements, and Financial Results 150

**NOODLECAKE STUDIOS, INC.** 151

---

Understand the Business 152

Why Adjustments Are Needed 152

Study the Accounting Methods 154

Making Required Adjustments 154

Preparing an Adjusted Trial Balance and the Financial Statements 166

Closing Temporary Accounts 170

Evaluate the Results 173

Adjusted Financial Results 173

[Review the Chapter](#) 174

[Practice Material](#) 181

## CHAPTER 5

Fraud, Internal Control, and Cash 212

**KOSS CORPORATION** 213

---

Fraud and Internal Control 214

Fraud 214

The Sarbanes-Oxley Act (SOX) 216

Internal Control 217

Internal Control for Cash 221

Controls for Cash Receipts 221

Controls for Cash Payments 224

Controls from Bank Procedures 227

Cash Reporting	227
Bank Statement	227
Bank Reconciliation	228
Reporting Cash	232
Restricted Cash	233
Supplement: 5A Petty Cash Systems	233
<a href="#">Review the Chapter</a>	235
<a href="#">Practice Material</a>	237

## CHAPTER 6

Merchandising Operations and the Multistep Income Statement	258
---	-----

<b>WALMART</b>	259
----------------	-----

---

Understand the Business	260
Operating Cycles	260
Inventory Systems	261
Study the Accounting Methods	264
Recording Inventory Purchases	264
Recording Inventory Sales	268
Evaluate the Results	274
Multistep Income Statement	274
Gross Profit Analysis	275
Supplement: 6A Recording Early Payment (“Cash”)	
Discounts on Purchases and Sales	276
Supplement: 6B Recording Inventory Transactions in a Periodic System	277
<a href="#">Review the Chapter</a>	279
<a href="#">Practice Material</a>	284

## CHAPTER 7

Inventory and Cost of Goods Sold	306
----------------------------------	-----

<b>AMERICAN EAGLE OUTFITTERS</b>	307
----------------------------------	-----

---

Understand the Business	308
Types of Inventory	308
Inventory Management Decisions	308
Study the Accounting Methods	309
Balance Sheet and Income Statement Reporting	309
Inventory Costing Methods	310
Lower of Cost or Market/Net Realizable Value	315
Evaluate Inventory Management	317
Inventory Turnover Analysis	317
Supplement: 7A FIFO, LIFO, and Weighted Average in a Perpetual Inventory System	320
Supplement: 7B The Effects of Errors in Ending Inventory	322
<a href="#">Review the Chapter</a>	323
<a href="#">Practice Material</a>	327

## CHAPTER 8

Receivables, Bad Debt Expense, and Interest Revenue	350
---	-----

<b>VF CORPORATION (VFC)</b>	351
-----------------------------	-----

---

Understand the Business	352
Pros and Cons of Extending Credit	352
Accounting for Accounts Receivable	353
Accounts Receivable and Bad Debts	353
Methods for Estimating Bad Debts	357
Accounting for Notes Receivable	360
Notes Receivable and Interest Revenue	360
Recording Notes Receivable and Interest Revenue	361
Evaluate Receivables Management	364
Receivables Turnover Analysis	364
Supplement: 8A Direct Write-Off Method	367
<a href="#">Review the Chapter</a>	368
<a href="#">Practice Material</a>	372

## CHAPTER 9

Long-Lived Tangible and Intangible Assets	394
---	-----

<b>CEDAR FAIR</b>	395
-------------------	-----

---

Understand the Business	396
Definition and Classification	396
Study the Accounting Methods	397
Tangible Assets	397
Intangible Assets	411
Evaluate the Results	414
Turnover Analysis	414
Impact of Depreciation Differences	415
Supplement: 9A Natural Resources	417
Supplement: 9B Changes in Depreciation	418
<a href="#">Review the Chapter</a>	419
<a href="#">Practice Material</a>	424

## CHAPTER 10

Liabilities	442
-------------	-----

<b>GENERAL MILLS</b>	443
----------------------	-----

---

Understand the Business	444
The Role of Liabilities	444
Study the Accounting Methods	445
Measuring Liabilities	445
Current Liabilities	445
Long-Term Liabilities	453
Contingent Liabilities	461

Evaluate the Results	462
Debt-to-Assets Ratio	462
Times Interest Earned Ratio	463
Supplement: 10A Straight-Line Method of Amortization	463
Supplement: 10B Effective-Interest Method of Amortization	465
Supplement: 10C Simplified Effective-Interest Amortization	469
Supplement: 10D Installment Notes Payable	473
<a href="#">Review the Chapter</a>	477
<a href="#">Practice Material</a>	484

## CHAPTER 11

Stockholders' Equity	506
<b>NATIONAL BEVERAGE CORP.</b>	507

Understand the Business	508
Corporate Ownership	508
Equity versus Debt Financing	509
Study the Accounting Methods	510
Common Stock Transactions	510
Stock Dividends and Stock Splits	517
Preferred Stock	520
Retained Earnings	522
Statement of Stockholders' Equity	522
Evaluate the Results	523
Earnings per Share (EPS)	523
Return on Equity (ROE)	524
Price/Earnings (P/E) Ratio	525
Supplement: 11A Owners' Equity for Other Forms of Business	525
Supplement: 11B Recording Stock Dividends	529
<a href="#">Review the Chapter</a>	530
<a href="#">Practice Material</a>	534

## CHAPTER 12

Statement of Cash Flows	554
<b>DAVE &amp; BUSTER'S ENTERTAINMENT, INC.</b>	555

Understand the Business	556
Business Activities and Cash Flows	556
Classifying Cash Flows	557
Study the Accounting Methods	560
Relationship to Other Financial Statements	560
Preparing the Statement of Cash Flows	561
Evaluate the Results	570
Evaluating Cash Flows	571
Operating Cash Flows Revisited (Direct Method)	573

Supplement: 12A Reporting Disposals of Property, Plant, and Equipment (Indirect Method)	577
Supplement: 12B T-Account Approach (Indirect Method)	578
<a href="#">Review the Chapter</a>	580
<a href="#">Practice Material</a>	584

## CHAPTER 13

Measuring and Evaluating Financial Performance	612
<b>LOWE'S</b>	613

Understand the Business	614
Horizontal, Vertical, and Ratio Analyses	614
Study the Accounting Methods	615
Horizontal (Trend) Computations	615
Vertical (Common Size) Computations	617
Ratio Computations	618
Evaluate the Results	620
Interpreting Horizontal and Vertical Analyses	620
Interpreting Ratio Analyses	621
Underlying Accounting Decisions and Concepts	625
Supplement: 13A Discontinued Operations and Comprehensive Income	628
Supplement: 13B Reviewing and Contrasting IFRS and GAAP	629
<a href="#">Review the Chapter</a>	630
<a href="#">Practice Material</a>	633

## APPENDIX A

Excerpts from the Fiscal 2019 10-K Annual Report of The Home Depot, Inc.	A1
Management's Report on Internal Control Over Financial Reporting	A2
Report of Independent Registered Public Accounting Firm	A3
Report of Independent Registered Public Accounting Firm	A4
The Home Depot, Inc. Notes to Consolidated Financial Statements	A11

## APPENDIX B

Excerpts from the Fiscal 2019 10-K Annual Report of Lowe's Companies, Inc.	B1
Management's Report on Internal Control Over Financial Reporting	B2
Report of Independent Registered Public Accounting Firm	B2
Report of Independent Registered Public Accounting Firm	B4
Notes to Consolidated Financial Statements	B9

**APPENDIX C**

<b>Present and Future Value Concepts</b>	C1
<b>Future Value of a Single Amount</b>	C1
Arithmetic Calculations	C2
Using Tables	C2
Using Excel	C2
Using a Financial Calculator App	C3
<b>Present Value of a Single Amount</b>	C4
Using Tables	C5
Using Excel	C5
Using a Financial Calculator App	C5
<b>Future Value of an Annuity</b>	C6
Using Tables	C7
Using Excel	C7
Using a Financial Calculator App	C7
The Power of Compounding and Regular Saving	C8
<b>Present Value of an Annuity</b>	C8
Using Tables	C9
Using Excel	C9

Using a Financial Calculator App C10

Interest Rates and Interest Periods C10

**Accounting Applications of Present Values** C10

Case A—Present Value of a Single Amount C10

Case B—Present Value of an Annuity C12

Case C—Present Value of a Single Amount and an Annuity  
(Bond Pricing) C14

**Practice Material** C21

**APPENDIX D** (Available in Connect)**Investments in Other Corporations** D1

Solutions to Multiple-Choice Questions Q1

Chart of Accounts CA1

Glossary G1

Company Index IND1

Subject Index IND5