Corporate Financial Accounting 16e

Carl S. Warren

Professor Emeritus of Accounting University of Georgia, Athens

Jefferson P. Jones

Associate Professor of Accounting
Auburn University



Brief Contents

1	Introduction to Accounting and Business		2
2	2 Analyzing Transactions		58
3 The Adjusting Process		usting Process	110
4	The Acc	ounting Cycle	160
5	Account	ting for Retail Businesses	236
6	Invento	ries	308
7	7 Internal Control and Cash		360
8	8 Receivables		408
9	9 Long-Term Assets: Fixed and Intangible		454
10	Liabilities: Current, Installment Notes, and Contingencies		506
11	1 Liabilities: Bonds Payable		556
12	Corpora	tions: Organization, Stock Transactions, and Dividends	596
13	Statement of Cash Flows		644
14	Financia	al Statement Analysis	704
Арр	endix A	Interest Tables	A-2
Арр	endix B	Selected Topics	B-1
Арр	endix C	Nike Inc., Form 10-K for the Fiscal Year Ended May 31, 2020 Selected Excerpts	C-1
Appendix D		Reversing Entries (online)	D-1
Appendix E		Special Journals and Subsidiary Ledgers (online)	E-1
Glossary		G-1	
Inde	ndex		

Contents

Introduction to Accounting and Business 2

Nature of Business and Accounting 4

Types of Businesses 4
Business Activities 5
Role of Accounting in Business 5
Role of Ethics in Accounting and Business 7
Opportunities for Accountants 8

Generally Accepted Accounting Principles (GAAP) 10

Characteristics of Financial Information 11 Assumptions 12 Principles 14

The Accounting Equation 14

Business Transactions and the Accounting Equation 15

Summary 19 Classifications of Stockholders' Equity 20

Financial Statements 21

Income Statement 23
Statement of Stockholders' Equity 23
Balance Sheet 24
Statement of Cash Flows 25
Interrelationships Among Financial Statements 26

Analysis for Decision Making 29

Ratio of Liabilities to Stockholders' Equity 29

Continuing Problem 54

Make a Decision 55

Take It Further 56

Pathways Challenge 13, 57

2 Analyzing Transactions 58

Using Accounts to Record Transactions 61

Chart of Accounts 62

Double-Entry Accounting System 64

Balance Sheet Accounts 64 Income Statement Accounts 64 Statement of Stockholders' Equity Accounts (Dividends) 65 Normal Balances 65 Journalizing 66

Posting Journal Entries to Accounts 70

Trial Balance 80

Errors Affecting the Trial Balance 80 Errors Not Affecting the Trial Balance 81

Analysis for Decision Making 82

Horizontal Analysis 82

Continuing Problem 105

Make a Decision 106

Take It Further 108

Pathways Challenge 77, 109

The Adjusting Process 110

Nature of the Adjusting Process 113

Accrual and Cash Bases of Accounting 113
Revenue and Expense Recognition 114
The Adjusting Process 114
Types of Accounts Requiring Adjustment 115

Adjusting Entries for Accruals 116

Accrued Revenues 116 Accrued Expenses 117

Adjusting Entries for Deferrals 120

Unearned Revenues 120 Prepaid Expenses 121

Adjusting Entries for Depreciation 124

Summary of Adjusting Process 126

Adjusted Trial Balance 130

Analysis for Decision Making 132

Vertical Analysis 132

Continuing Problem 154

Make a Decision 155

Take It Further 157

Pathways Challenge 131, 159

The Accounting Cycle 160

Flow of Accounting Information 163

Financial Statements 165

Income Statement 165 Statement of Stockholders' Equity 165 Balance Sheet 167 Statement of Cash Flows 168

Closing Entries 170

Journalizing and Posting Closing Entries 171 Post-Closing Trial Balance 176

Accounting Cycle 177

Illustration of the Accounting Cycle 180

Step 1. Analyzing and Recording Transactions in the Journal 180

Step 2. Posting Transactions to the Ledger 181

Step 3. Preparing an Unadjusted Trial Balance 181

Step 4. Assembling and Analyzing Adjustment Data 181

Step 5. Preparing an Optional End-of-Period Spreadsheet 183

Step 6. Journalizing and Posting Adjusting Entries 184

Step 7. Preparing an Adjusted Trial Balance 184

Step 8. Preparing the Financial Statements 184

Step 9. Journalizing and Posting Closing Entries 187

Step 10. Preparing a Post-Closing Trial Balance 187

Why Is the Accrual Basis of Accounting Required by GAAP? 190

Analysis for Decision Making 192

Working Capital and Current Ratio 192

Appendix 1 End-of-Period Spreadsheet 194

Step 1. Enter the Title 194

Step 2. Enter the Unadjusted Trial Balance 194

Step 3. Enter the Adjustments 195

Step 4. Enter the Adjusted Trial Balance 196

Step 5. Extend the Accounts to the Income Statement and Balance Sheet Columns 197

Step 6. Total the Income Statement and Balance Sheet Columns, Compute the Net Income or Net Loss, and Complete the Spreadsheet 198

Preparing the Financial Statements

from the Spreadsheet 199

Appendix 2 Statement of Cash Flows for NetSolutions 199

Continuing Problem 228

Comprehensive Problem 1 229

Make a Decision 231

Take It Further 233

Pathways Challenge 177, 235

Accounting for Retail Businesses 236

Nature of Retail Businesses 238

Operating Cycle 238 Financial Statements 239

Merchandise Transactions 240

Chart of Accounts for Retail Business 240

Subsidiary Ledgers 241

Purchases Transactions 241

Sales Transactions 246

Freight 256

Summary: Recording Inventory Transactions 258

Dual Nature of Merchandise Transactions 259

Sales Taxes and Trade Discounts 259

The Adjusting Process 261

Inventory Shrinkage 261

Customer Returns, Refunds, and Allowances 262

Adjusted Trial Balance 263

Financial Statements and Closing Entries for

a Retail Business 264

Multiple-Step Income Statement 264

Single-Step Income Statement 266

Statement of Stockholders' Equity 266

Balance Sheet 267

The Closing Process 268

Analysis for Decision Making 269

Asset Turnover Ratio 269

Appendix 1 Sales Discounts 270

Gross Method 270

Net Method 272

Comparison of Gross and Net Methods 273

Appendix 2 The Periodic Inventory System 273

Chart of Accounts Under the Periodic Inventory System 273

Recording Merchandise Transactions Under the Periodic Inventory System 274

Adjusting Process Under the Periodic Inventory System 275

Financial Statements Under the Periodic Inventory System 276

Closing Entries Under the Periodic Inventory System 276

Comprehensive Problem 2 302

Make a Decision 303

Take It Further 305

Pathways Challenge 246, 307



Control of Inventory 310

Safeguarding Inventory 310 Reporting Inventory 311

Inventory Cost Flow Assumptions 311

Inventory Costing Methods Under a Perpetual Inventory System 313

First-In, First-Out Method 313

Last-In, First-Out Method 315

Weighted Average Cost Method 317

Inventory Costing Methods Under a Periodic Inventory System 319

First-In, First-Out Method 319

Last-In, First-Out Method 319

Weighted Average Cost Method 320

Comparing Inventory Costing Methods 323

Reporting Inventory in the Financial

Statements 324

Valuation at Lower of Cost or Market 324

Inventory on the Balance Sheet 326
Effects of Inventory Errors on the Financial Statements 327

Analysis for Decision Making 330

Inventory Turnover and Days' Sales in Inventory 330

Appendix Estimating Inventory Cost 332

Retail Method of Inventory Costing 332 Gross Profit Method of Inventory Costing 333

Make a Decision 355

Take It Further 356

Pathways Challenge 327, 358

Internal Control and Cash 360

Sarbanes-Oxley Act 362

Internal Control 364

Objectives of Internal Control 364
Elements of Internal Control 364
Control Environment 365
Risk Assessment 366
Control Procedures 366
Monitoring 368
Information and Communication 368
Limitations of Internal Control 369

Cash Controls over Receipts and Payments 370

Control of Cash Receipts 370 Control of Cash Payments 373

Bank Accounts 374

Bank Statement 374

Using the Bank Statement as a Control over Cash 376

Bank Reconciliation 377

Special-Purpose Cash Funds 381

Financial Statement Reporting of Cash 382

Analysis for Decision Making 383

Days' Cash on Hand 383

Make a Decision 403

Take It Further 404

Pathways Challenge 383, 406

Receivables 408

Classification of Receivables 410

Accounts Receivable 410 Notes Receivable 410 Other Receivables 411

Uncollectible Receivables 411

Direct Write-Off Method for Uncollectible Accounts 412

Allowance Method for Uncollectible Accounts 413

Write-Offs to the Allowance Account 413 Estimating Uncollectibles 415

Comparing Direct Write-Off and Allowance Methods 422

Notes Receivable 423

Characteristics of Notes Receivable 423 Accounting for Notes Receivable 424

Reporting Receivables on the Balance Sheet 427

Analysis for Decision Making 428

Accounts Receivable Turnover and Days' Sales in Receivables 428

Make a Decision 450

Take It Further 452

Pathways Challenge 426, 453



Nature of Fixed Assets 456

Classifying Costs 456 The Cost of Fixed Assets 458 Leasing Fixed Assets 459

Accounting for Depreciation 460

Factors in Computing Depreciation Expense 460 Straight-Line Method 461 Units-of-Activity Method 463 Double-Declining-Balance Method 465 Comparing Depreciation Methods 466 Partial-Year Depreciation 469 Revising Depreciation Estimates 470 Repair and Improvements 471

Disposal of Fixed Assets 473

Discarding Fixed Assets 473 Selling Fixed Assets 474

Natural Resources 475

Intangible Assets 477

Patents 477 Copyrights and Trademarks 478 Goodwill 478

Financial Reporting for Long-Term Assets: Fixed and Intangible 480

Analysis for Decision Making 481

Fixed Asset Turnover Ratio 481

Appendix Exchanging Similar Fixed Assets 483

Gain on Exchange 483 Loss on Exchange 484

Make a Decision 502

Take It Further 503

Pathways Challenge 479, 505

10 Liabilities: Current, Installment Notes, and Contingencies 506

Current Liabilities 508

Accounts Payable and Accruals 508 Short-Term Notes Payable 509 Current Portion of Long-Term Debt 511

Payroll Liabilities 511

Liability for Employee Earnings 512
Deductions from Employee Earnings 512
Computing Employee Net Pay 513
Employer's Payroll Taxes 514
Recording Payroll 515
Paying Payroll 517
Internal Controls for Payroll 517

Employees' Fringe Benefits 517

Vacation Pay 517
Pensions 518
Postretirement Benefits Other than Pensions 520

Installment Notes 520

Issuance 520 Periodic Payments 520

Contingent Liabilities 523

Probable and Estimable 523 Probable and Not Estimable 523 Reasonably Possible 524 Remote 524

Reporting Liabilities 526

Analysis for Decision Making 527

Short-Term Liquidity Analysis 527

Comprehensive Problem 3 547

Make a Decision 549

Take It Further 552

Pathways Challenge 525, 554

Liabilities: Bonds Payable 556

Nature of Bonds Payable 558

Bond Characteristics and Terminology 558 Proceeds from Issuing Bonds 559

Accounting for Bonds Payable 561

Bonds Issued at Face Amount 561 Bonds Issued at a Discount 562 Amortizing a Bond Discount 562 Bonds Issued at a Premium 564 Amortizing a Bond Premium 565 Bond Redemption 567

Reporting Bonds Payable 569

Analysis for Decision Making 570

Times Interest Earned 570

Appendix 1 Present Value Concepts and Pricing Bonds Payable 572

Present Value Concepts 572 Pricing Bonds 575 Computing Present Values 576

Appendix 2 Effective Interest Rate Method of Amortization 576

Amortization of Discount by the Interest Method 577 Amortization of Premium by the Interest Method 578

Make a Decision 593

Take It Further 594

Pathways Challenge 568, 595

1 2 Corporations: Organization, Stock Transactions, and Dividends 596

Nature of a Corporation 598

Characteristics of a Corporation 598 Forming a Corporation 599

Paid-In Capital from Stock 601

Characteristics of Stock 601 Types of Stock 602 Issuing Stock 604 Premium on Stock 605 No-Par Stock 606

Accounting for Dividends 607

Cash Dividends 608 Stock Dividends 609

Stock Splits 611

Treasury Stock Transactions 612

Reporting Stockholders' Equity 614

Stockholders' Equity on the Balance Sheet 614
Reporting Retained Earnings 615
Statement of Stockholders' Equity 617
Reporting Stockholders' Equity for Alphabet 618

Analysis for Decision Making 619

Earnings per Share 619

Comprehensive Problem 4 637

Make a Decision 639

Take It Further 640

Pathways Challenge 604, 643

13 Statement of Cash Flows 644

Reporting Cash Flows 646

Cash Flows: Operating Activities 647 Cash Flows: Investing Activities 649 Cash Flows: Financing Activities 649

Noncash Investing and Financing Activities 650 Format of the Statement of Cash Flows 650

No Cash Flow per Share 651

Cash Flows: Operating Activities 651

Net Income 653

Adjustments to Net Income 653

Cash Flows: Investing Activities 657

Land 657

Building and Accumulated Depreciation—Building 658

Cash Flows: Financing Activities 659

Bonds Payable 659 Common Stock 659

Dividends and Dividends Payable 660

Preparing the Statement of Cash Flows 661

Analysis for Decision Making 663

Free Cash Flow 663

Appendix 1 Spreadsheet (Work Sheet) for Statement of Cash Flows—The Indirect Method 664

Analyzing Accounts 665 Retained Earnings 666 Other Accounts 666

Preparing the Statement of Cash Flows 667

Appendix 2 Preparing the Statement of Cash Flows—The Direct Method 667

Cash Received from Customers 668 Cash Payments for Merchandise 668 Cash Payments for Operating Expenses 669

Gain on Sale of Land 669 Interest Expense 670

Cash Payments for Income Taxes 670

Reporting Cash Flows from (Used for) Operating Activities—Direct Method 670

Make a Decision 698

Take It Further 701

Pathways Challenge 661, 702

Financial Statement Analysis 704

Analyzing and Interpreting Financial Statements 706

The Value of Financial Statement Information 706
Techniques for Analyzing Financial Statements 707

Analytical Methods 707

Horizontal Analysis 707 Vertical Analysis 709 Common-Sized Statements 711

Analyzing Liquidity 713

Current Position Analysis 713 Accounts Receivable Analysis 714 Inventory Analysis 715

Analyzing Solvency 718

Ratio of Fixed Assets to Long-Term Liabilities 718 Ratio of Liabilities to Stockholders' Equity 718 Times Interest Earned 719

Analyzing Profitability 720

Asset Turnover 721

Return on Total Assets 721

Return on Stockholders' Equity 722

Return on Common Stockholders' Equity 723

Earnings per Share on Common Stock 724

Price-Earnings Ratio 725

Dividends per Share 726

Dividend Yield 726

Summary of Analytical Measures 728

Corporate Annual Reports 729

Management Discussion and Analysis 729

Report on Internal Control 730

Report on Fairness of the Financial Statements 730

Make a Decision 757

Take It Further 758

Pathways Challenge 725, 760

Appendix A: Interest Tables A-2

Appendix B: Selected Topics B-1

Topic 1: Investments

Topic 2: Foreign Currency Transactions

Topic 3: Corporate Taxes

Topic 4: Reporting Unusual Items and Comprehensive Income

Topic 5: Revenue Recognition

Topic 6: International Accounting Standards

Appendix C: Nike Inc., Form 10-K for the Fiscal Year Ended May 31, 2020 Selected Excerpts C-1

Appendix D: Reversing Entries (online) D-1

Appendix E: Special Journals and Subsidiary Ledgers (online) E-1

Glossary G-1

Index I-1