

Intermediate Accounting

SEVENTH EDITION

J. DAVID SPICELAND

University of Memphis

JAMES F. SEPE

Santa Clara University

MARK W. NELSON

Cornell University

 **McGraw-Hill
Irwin**

Contents in Brief

The Role of Accounting as an Information System

SECTION

- 1 Environment and Theoretical Structure of Financial Accounting 2
- 2 Review of the Accounting Process 50
- 3 The Balance Sheet and Financial Disclosures 112
- 4 The Income Statement, Comprehensive Income, and the Statement of Cash Flows 170
- 5 Income Measurement and Profitability Analysis 230
- 6 Time Value of Money Concepts 320

1

Economic Resources

SECTION

- 7 Cash and Receivables 358
- 8 Inventories: Measurement 420
- 9 Inventories: Additional Issues 474
- 10 Property, Plant, and Equipment and Intangible Assets: Acquisition and Disposition 528
- 11 Property, Plant, and Equipment and Intangible Assets: Utilization and Impairment 588

2

Financial Instruments and Liabilities

SECTION

- 12 Investments 652
- 13 Current Liabilities and Contingencies 736
- 14 Bonds and Long-Term Notes 796
- 15 Leases 858
- 16 Accounting for Income Taxes 946
- 17 Pensions and Other Postretirement Benefits 1008
- 18 Shareholders' Equity 1078

3

Additional Financial Reporting Issues

SECTION

- 19 Share-Based Compensation and Earnings Per Share 1138
- 20 Accounting Changes and Error Corrections 1206
- 21 The Statement of Cash Flows Revisited 1256

4

Appendix A: Derivatives A-0

Appendix B: Dell Annual Report B-1

Appendix C: IFRS Comprehensive Case C-1

Glossary G-0

Photo Credits C-1

Index I-1

Present and Future Value Tables P-1

Contents

1 The Role of Accounting as an Information System

1 CHAPTER Environment and Theoretical Structure of Financial Accounting 2



Part A: Financial Accounting Environment 3

- The Economic Environment and Financial Reporting 5
 - The Investment-Credit Decision—A Cash Flow Perspective 6
 - Cash versus Accrual Accounting 6
- The Development of Financial Accounting and Reporting Standards 8
 - Historical Perspective and Standards 8
 - The Establishment of Accounting Standards 13
- Encouraging High-Quality Financial Reporting 15
 - The Role of the Auditor 15
 - Financial Reporting Reform 16
- A Move Away from Rules-Based Standards? 17
 - Ethics in Accounting 18

Part B: The Conceptual Framework 19

- Objective of Financial Reporting 21
- Qualitative Characteristics of Financial Reporting Information 21
 - Fundamental Qualitative Characteristics 22
 - Enhancing Qualitative Characteristics 23
 - Key Constraint: Cost Effectiveness 24
- Elements of Financial Statements 24
- Underlying Assumptions 25
 - Economic Entity Assumption 25
 - Going Concern Assumption 26
 - Periodicity Assumption 26
 - Monetary Unit Assumption 26
- Recognition, Measurement, and Disclosure Concepts 27
 - Recognition 27
 - Measurement 29
 - Disclosure 32
- Evolving GAAP 32
- Questions For Review of Key Topics 36
- Brief Exercises 37
- Exercises 38

- CPA and CMA Exam Questions 42
- Broaden Your Perspective 44
- Air France–KLM Case 48

2 CHAPTER Review of the Accounting Process 50



- The Basic Model 52
 - The Accounting Equation 52
 - Account Relationships 54
- The Accounting Processing Cycle 55
- Concept Review Exercise: Journal Entries for External Transactions 64
- Adjusting Entries 66
 - Prepayments 67
 - Accruals 70
 - Estimates 72
- Concept Review Exercise: Adjusting Entries 74
- Preparing the Financial Statements 75
 - The Income Statement 75
 - The Statement of Comprehensive Income 76
 - The Balance Sheet 76
 - The Statement of Cash Flows 78
 - The Statement of Shareholders' Equity 79
- The Closing Process 79
- Concept Review Exercise: Financial Statement Preparation and Closing 81
- Conversion from Cash Basis to Accrual Basis 83
- Appendix 2A: Use of a Worksheet 87
- Appendix 2B: Reversing Entries 88
- Appendix 2C: Subsidiary Ledgers and Special Journals 90
- Questions For Review of Key Topics 93
- Brief Exercises 93
- Exercises 94
- CPA Review Questions 101
- Problems 102
- Broaden Your Perspective 109

3 CHAPTER The Balance Sheet and Financial Disclosures 112



Part A: The Balance Sheet 115

Usefulness and Limitations 115

Classifications 116

- Assets 116
- Liabilities 120
- Shareholders' Equity 121

Concept Review Exercise: Balance Sheet Classification 123

Part B: Financial Disclosures 124

Disclosure Notes 125

- Summary of Significant Accounting Policies 125
- Subsequent Events 125
- Noteworthy Events and Transactions 126

Management Discussion and Analysis 128

Management's Responsibilities 129

Auditors' Report 130

Compensation of Directors and Top Executives 131

Part C: Risk Analysis 132

Using Financial Statement Information 132

Liquidity Ratios 134

- Financing Ratios 135

Appendix 3: Reporting Segment Information 140

Questions For Review of Key Topics 143

Brief Exercises 144

Exercises 145

CPA and CMA Review Questions 153

Problems 154

Broaden Your Perspective 160

Air France–KLM Case 168

4 CHAPTER The Income Statement, Comprehensive Income, and the Statement of Cash Flows 170



Part A: The Income Statement And Comprehensive Income 172

Income from Continuing Operations 172

- Revenues, Expenses, Gains, and Losses 173
- Income Tax Expense 174
- Operating versus Nonoperating Income 174
- Income Statement Formats 175

Earnings Quality 177

- Manipulating Income and Income Smoothing 177
- Operating Income and Earnings Quality 178
- Nonoperating Income and Earnings Quality 181

Separately Reported Items 182

- Intraperiod Income Tax Allocation 182
- Discontinued Operations 184

- Extraordinary Items 188
- Unusual or Infrequent Items 189
- Accounting Changes 190**
 - Change in Accounting Principle 190
 - Change in Depreciation, Amortization, or Depletion Method 191
 - Change in Accounting Estimate 191
- Correction of Accounting Errors 191**
 - Prior Period Adjustments 191
- Earnings per Share Disclosures 192**
- Comprehensive Income 192**
 - Other Comprehensive Income 193
 - Flexibility in Reporting 193
 - Accumulated Other Comprehensive Income 195

Concept Review Exercise: Income Statement Presentation; Comprehensive Income 196

Part B: The Statement of Cash Flows 198

Usefulness of the Statement of Cash Flows 198

Classifying Cash Flows 198

- Operating Activities 198
- Investing Activities 202
- Financing Activities 203
- Noncash Investing and Financing Activities 203

Concept Review Exercise: Statement of Cash Flows 204

Questions For Review of Key Topics 208

Brief Exercises 208

Exercises 210

CPA and CMA Review Questions 216

Problems 218

Broaden Your Perspective 223

Air France–KLM Case 229

CPA Simulation 4–1 229

5 CHAPTER Income Measurement and Profitability Analysis 230



Part A: Revenue Recognition 232

Revenue Recognition at Delivery 236

- Product Revenue 236
- Service Revenue 236
- Is the Seller a Principal or an Agent? 237

Revenue Recognition after Delivery 238

- Installment Sales 239

Concept Review Exercise: Installment Sales 242

- Right of Return 243

Consignment Sales 244

Revenue Recognition Prior to Delivery 244

- A Comparison of the Completed Contract and Percentage-of-Completion Methods 251

Concept Review Exercise: Long-Term Construction Contracts 256

Industry-Specific Revenue Issues 258

- Software and Other Multiple-Element Arrangements 258
- Franchise Sales 260

Part B: Profitability Analysis 263

- Activity Ratios 263
- Profitability Ratios 264

Profitability Analysis—An Illustration 267
 Appendix 5: Interim Reporting 270
Questions For Review of Key Topics 273
Brief Exercises 273
Exercises 275
CPA and CMA Review Questions 282
Problems 285
Broaden Your Perspective 292
Air France—KLM Case 299

Where We're Headed A Chapter Supplement: Revenue Recognition 300

**Concept Review Exercise: Accounting for Revenue
 In Single-Period Contracts 313**

Questions For Review of Key Topics 315
Brief Exercises 315
Exercises 316
Problems 317



6 CHAPTER Time Value of Money Concepts 320

Part A: Basic Concepts 322

Time Value of Money 322
 Simple versus Compound Interest 322
 Valuing a Single Cash Flow Amount 323
 Future Value of a Single Amount 323
 Present Value of a Single Amount 324

Solving for Other Values When FV and PV are Known 326

Concept Review Exercise: Valuing a Single Cash Flow Amount 327

Preview of Accounting Applications of Present Value
 Techniques—Single Cash Amount 328
 Expected Cash Flow Approach 330

Part B: Basic Annuities 331

Future Value of an Annuity 332
 Future Value of an Ordinary Annuity 332
 Future Value of an Annuity Due 333
 Present Value of an Annuity 334
 Present Value of an Ordinary Annuity 334
 Present Value of an Annuity Due 336
 Present Value of a Deferred Annuity 337

Financial Calculators and Excel 338

Solving for Unknown Values in Present Value
 Situations 339

Concept Review Exercise: Annuities 341

Preview of Accounting Applications of Present Value
 Techniques—Annuities 342
 Valuation of Long-Term Bonds 342
 Valuation of Long-Term Leases 343
 Valuation of Pension Obligations 344

Summary of Time Value of Money Concepts 345

Questions For Review of Key Topics 347

Brief Exercises 347

Exercises 348

CPA and CMA Review Questions 351

Problems 353

Broaden Your Perspective 356

2 Economic Resources

7 CHAPTER Cash and Receivables 358

Part A: Cash and Cash Equivalents 359

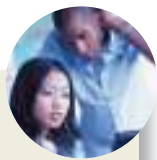
Internal Control 360
 Internal Control Procedures—Cash Receipts 361
 Internal Control Procedures—Cash Disbursements 361
 Restricted Cash and Compensating Balances 362
 Decision Makers' Perspective 363

Part B: Current Receivables 364

Accounts Receivable 364
 Initial Valuation of Accounts Receivable 364
 Subsequent Valuation of Accounts Receivable 366

Concept Review Exercise: Uncollectible Accounts Receivable 373

Notes Receivable 374
 Interest-Bearing Notes 375
 Noninterest-Bearing Notes 375



Subsequent Valuation of Notes Receivable 377

Financing with Receivables 379

Secured Borrowing 379
 Sale of Receivables 380
 Transfers of Notes Receivable 382
 Deciding Whether to Account for a Transfer
 as a Sale or a Secured Borrowing 383
 Disclosures 386

Concept Review Exercise: Financing with Receivables 387

Decision Makers' Perspective 388

Appendix 7A: Cash Controls 392

Appendix 7B: Accounting For Impairment of a Receivable
 and a Troubled Debt Restructuring 395

Questions For Review of Key Topics 398

Brief Exercises 399

Exercises 401

CPA and CMA Review Questions 407

Problems 409

Broaden Your Perspective 415

Air France—KLM Case 419



8 CHAPTER Inventories: Measurement 420

Part A: Recording and Measuring Inventory 422

Types of Inventory 422

- Merchandising Inventory 422
- Manufacturing Inventories 422

Types of Inventory Systems 424

- Perpetual Inventory System 424
- Periodic Inventory System 425
- A Comparison of the Perpetual and Periodic Inventory Systems 426

What Is Included in Inventory? 426

- Physical Quantities Included in Inventory 426
- Expenditures Included in Inventory 427

Inventory Cost Flow Assumptions 430

- Specific Identification 431
- Average Cost 431
- First-In, First-Out (FIFO) 433
- Last-In, First-Out (LIFO) 434
- Comparison of Cost Flow Methods 436

Decision Makers' Perspective—Factors Influencing Method Choice 437

Concept Review Exercise: Inventory Cost Flow Methods 440

Decision Makers' Perspective 443

Part B: Methods of Simplifying LIFO 446

LIFO Inventory Pools 446

Dollar-Value LIFO 447

- Advantages of DVL 448
- Cost Indexes 448
- The DVL Inventory Estimation Technique 448

Concept Review Exercise: Dollar-Value LIFO 449

Questions For Review of Key Topics 451

Brief Exercises 452

Exercises 453


CPA and CMA Review Questions 459

Problems 461

Broaden Your Perspective 468

Air France—KLM Case 472

CPA Simulation 8–1 472



9 CHAPTER Inventories: Additional Issues 474

Part A: Reporting—Lower of Cost or Market 476

Determining Market Value 477

- Applying Lower of Cost or Market 479
- Adjusting Cost to Market 480

Concept Review Exercise: Lower of Cost or Market 482

Part B: Inventory Estimation Techniques 483

The Gross Profit Method 484

- A Word of Caution 485

The Retail Inventory Method 486

- Retail Terminology 487
- Cost Flow Methods 488
- Other Issues Pertaining to the Retail Method 491

Concept Review Exercise: Retail Inventory Method 492

Part C: Dollar-Value LIFO Retail 494

Concept Review Exercise: Dollar-Value LIFO Retail Method 496

Part D: Change in Inventory Method and Inventory Errors 497

Change in Inventory Method 497

- Most Inventory Changes 497
- Change to the LIFO Method 499

Inventory Errors 500

- When the Inventory Error Is Discovered the Following Year 502
- When the Inventory Error Is Discovered Subsequent to the Following Year 502

Concept Review Exercise: Inventory Errors 502

Earnings Quality 503

Appendix 9: Purchase Commitments 505

Questions For Review of Key Topics 506

Brief Exercises 507

Exercises 509


CPA and CMA Review Questions 516

Problems 518

Broaden Your Perspective 524

Air France—KLM Case 527

CPA Simulation 9–1 527



10 CHAPTER Property, Plant, and Equipment and Intangible Assets: Acquisition and Disposition 528

Part A: Valuation at Acquisition 530

Types of Assets 530

Costs to Be Capitalized 532

- Property, Plant, and Equipment 532
- Intangible Assets 537

Lump-Sum Purchases 540

Noncash Acquisitions 541

- Deferred Payments 542
- Issuance of Equity Securities 543
- Donated Assets 544

Decision Makers' Perspective 545

Part B: Dispositions and Exchanges 546

Dispositions 546

Exchanges 547

- Fair Value Not Determinable 548
- Exchange Lacks Commercial Substance 549

Concept Review Exercise: Exchanges 550

Part C: Self-Constructed Assets and Research and Development 551

Self-Constructed Assets 551

- Overhead Allocation 551
- Interest Capitalization 551
- Research and Development (R&D) 556

Appendix 10: Oil And Gas Accounting 564
Questions For Review of Key Topics 565
Brief Exercises 566
Exercises 568
CPA and CMA Review Questions 574
Problems 577
Broaden Your Perspective 581
Air France—KLM Case 585
CPA Simulation 10–1 586

11 CHAPTER

Property, Plant, and Equipment and Intangible Assets: Utilization and Impairment 588



Part A: Depreciation, Depletion, and Amortization 590

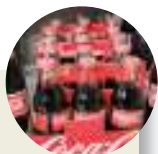
Cost Allocation—an Overview 590
 Measuring Cost Allocation 591
 Service Life 591
 Allocation Base 591
 Allocation Method 592
 Depreciation 592
 Time-Based Depreciation Methods 592
 Activity-Based Depreciation Methods 594
 Decision Makers' Perspective—Selecting A Depreciation Method 595
Concept Review Exercise: Depreciation Methods 597
 Group and Composite Depreciation Methods 598
 Depletion of Natural Resources 602
 Amortization of Intangible Assets 603

Intangible Assets Subject to Amortization 604
 Intangible Assets Not Subject to Amortization 605
Concept Review Exercise: Depletion and Amortization 607
Part B: Additional Issues 608
 Partial Periods 608
 Changes in Estimates 609
 Change in Depreciation, Amortization, or Depletion Method 610
 Error Correction 611
 Impairment of Value 613
 Assets to Be Held and Used 613
 Assets to Be Sold 620
 Impairment Losses and Earnings Quality 621
Part C: Subsequent Expenditures 622
 Expenditures Subsequent to Acquisition 622
 Repairs and Maintenance 623
 Additions 623
 Improvements 623
 Rearrangements 624
 Costs of Defending Intangible Rights 624
 Appendix 11A: Comparison With Macrs (Tax Depreciation) 627
 Appendix 11B: Retirement And Replacement Methods of Depreciation 627
Questions For Review of Key Topics 629
Brief Exercises 629
Exercises 631
CPA and CMA Review Questions 638
Problems 641
Broaden Your Perspective 646
Air France—KLM Case 651
CPA Simulation 11–1 651

3 Financial Instruments and Liabilities

12 CHAPTER

Investments 652



Part A: Investor Lacks Significant Influence 654

Securities to Be Held to Maturity 656
 Trading Securities 659
 Securities Available-for-Sale 663
 Comparison of HTM, TS, and AFS Approaches 669
 Transfers between Reporting Categories 671
 Fair Value Option 672
 Impairment of Investments 673
Concept Review Exercise: Various Investment Securities 674
 Financial Statement Presentation and Disclosure 677

Part B: Investor Has Significant Influence 679

How the Equity Method Relates to Consolidated Financial Statements 679
 What Is Significant Influence? 680
 A Single Entity Concept 680
 Further Adjustments 682
 Reporting the Investment 684
 What If Conditions Change? 686
 If an Equity Method Investment Is Sold 687
 Comparison of Fair Value and the Equity Method 687
 Fair Value Option 688
Concept Review Exercise: The Equity Method 689
 Decision Makers' Perspective 691
 Financial Instruments and Investment Derivatives 692
 Appendix 12A: Other Investments (Special Purpose Funds, Investments in Life Insurance Policies) 694

Appendix 12B: Impairment of Investments 696
Questions For Review of Key Topics 702
Brief Exercises 703
Exercises 705
CPA and CMA Review Questions 712
Problems 715
Broaden Your Perspective 721
Air France–KLM Case 725
CPA Simulation 12–1 725

Where We're Headed A Chapter Supplement: **Investments** 726

**Concept Review Exercise: Identifying the Accounting
 Approach Used for Investments** 732

Questions For Review of Key Topics 733

Brief Exercises 733

Exercises 734

Problem 734

13 CHAPTER Current Liabilities and Contingencies 736

Part A: Current Liabilities 738

Characteristics of Liabilities 738

What Is a Current Liability? 739

Open Accounts and Notes 740

Accounts Payable and Trade Notes Payable 740

Short-Term Notes Payable 741

Commercial Paper 743

Accrued Liabilities 744

Accrued Interest Payable 744

Salaries, Commissions, and Bonuses 744

Liabilities from Advance Collections 746

Deposits and Advances from Customers 746

Gift Cards 748

Collections for Third Parties 748

**A Closer Look at the Current and Noncurrent
 Classification** 748

Current Maturities of Long-Term Debt 749

Obligations Callable by the Creditor 749

When Short-Term Obligations Are Expected
 to Be Refinanced 749

Concept Review Exercise: Current Liabilities 751

Part B: Contingencies 752

Loss Contingencies 752

Product Warranties and Guarantees 754

Premiums 757

Litigation Claims 759

Subsequent Events 760

Unasserted Claims and Assessments 762

Gain Contingencies 764

Concept Review Exercise: Contingencies 764

Decision Makers' Perspective 766

Appendix 13: Payroll-Related Liabilities 769

Questions For Review of Key Topics 771

Brief Exercises 772

Exercises 773

CPA and CMA Review Questions 780

Problems 782

Broaden Your Perspective 787

Air France–KLM Case 794

14 CHAPTER Bonds and Long-Term Notes 796

The Nature of Long-Term Debt 797

Part A: Bonds 798

The Bond Indenture 798

Recording Bonds at Issuance 799

Determining the Selling Price 799

Determining Interest—Effective Interest Method 802

Zero-Coupon Bonds 803

Bonds Sold at a Premium 804

When Financial Statements Are Prepared between
 Interest Dates 806

The Straight-Line Method—A Practical Expediency 807

**Concept Review Exercise: Issuing Bonds
 and Recording Interest** 808

Debt Issue Costs 809

Part B: Long-term Notes 810

Note Issued for Cash 810

Note Exchanged for Assets or Services 811

Installment Notes 813

Financial Statement Disclosures 814

Decision Makers' Perspective 815

**Concept Review Exercise: Note with an Unrealistic
 Interest Rate** 818

Part C: Debt Retired Early, Convertible Into Stock, or Providing an Option to Buy Stock 819

Early Extinguishment of Debt 819

Convertible Bonds 820

When the Conversion Option Is Exercised 822

Induced Conversion 823

Bonds with Detachable Warrants 823

**Concept Review Exercise: Issuance and Early
 Extinguishment of Debt** 824

Part D: Option to Report Liabilities at Fair Value 825

Determining Fair Value 826

Reporting Changes in Fair Value 826

Mix and Match 828

Counterintuitive Effect 828

Appendix 14A: Bonds Issued Between
 Interest Dates 830

Appendix 14B: Troubled Debt Restructuring 831

Questions For Review of Key Topics 835

Brief Exercises 836

Exercises 838

CPA and CMA Review Questions 844

Problems 846

Broaden Your Perspective 852

Air France–KLM Case 856

CPA Simulation 14–1 857



15 CHAPTER Leases 858

Part A: Accounting by The Lessor And Lessee 859

Decision Makers' Perspective—Advantages of Leasing 860

Capital Leases and Installment Notes Compared 861

Lease Classification 862

Classification Criteria 862

Additional Lessor Conditions 864

Operating Leases 866

Advance Payments 867

Leasehold Improvements 868

Capital Leases—Lessee and Lessor 868

Depreciation 870

Accrued Interest 871

Concept Review Exercise: Direct Financing Lease 872

Sales-Type Leases 873

Part B: Bargain Purchase Options and Residual Value 876

Bargain Purchase Options 876

When a BPO Is Exercisable Before the End of the Lease Term 878

Residual Value 878

Effect on the Lessee of a Residual Value 879

Effect on the Lessor of a Residual Value 880

Part C: Other Lease Accounting Issues 883

Executory Costs 883

Discount Rate 884

When the Lessee's Incremental Borrowing Rate is Less Than the Lessor's Implicit Rate 885

When the Lessor's Implicit Rate is Unknown 885

Lessor's Initial Direct Costs 886

Contingent Rentals 887

A Brief Summary 887

Lease Disclosures 887

Decision Makers' Perspective—Financial Statement Impact 890

Balance Sheet and Income Statement 890

Statement of Cash Flow Impact 891

Concept Review Exercise: Various Lease Accounting Issues 892

Part D: Special Leasing Arrangements 894

Sale-Leaseback Arrangements 894

Capital Leases 895

Operating Leases 896

Losses on Sale-Leasebacks 897

Real Estate Leases 897

Leases of Land Only 898

Leases of Land and Building 898

Leases of Only Part of a Building 898

Questions For Review of Key Topics 900

Brief Exercises 900

Exercises 902

CPA and CMA Review Questions 909

Problems 912

Broaden Your Perspective 919

Air France–KLM Case 922

CPA Simulation 15–1 922

Where We're Headed A Chapter Supplement: Leases 923

Questions For Review of Key Topics 938

Brief Exercises 939

Exercises 940

Problems 944



16 CHAPTER Accounting for Income Taxes 946

Part A: Deferred Tax Assets and Deferred Tax Liabilities 948

Conceptual Underpinning 948

Temporary Differences 949

Deferred Tax Liabilities 949

The FASB's Balance Sheet Approach 951

Types of Temporary Differences 952

Deferred Tax Assets 956

Valuation Allowance 959

Permanent Differences 960

Concept Review Exercise: Temporary and Permanent Differences 963

Part B: Other Tax Accounting Issues 964

Tax Rate Considerations 964

When Enacted Tax Rates Differ 964

Changes in Tax Laws or Rates 965

Multiple Temporary Differences 966

Net Operating Losses 968

Operating Loss Carryforward 969

Operating Loss Carryback 970

Financial Statement Presentation 971

Balance Sheet Classification 971

Disclosure Notes 972

Coping with Uncertainty in Income Taxes 974

Intraperiod Tax Allocation 976

Decision Makers' Perspective 978

Concept Review Exercise: Multiple Differences and Operating Loss 979

Questions For Review of Key Topics 982

Brief Exercises 983

Exercises 985


CPA and CMA Review Questions 992

Problems 994

Broaden Your Perspective 1001

Air France–KLM Case 1005

CPA Simulation 16–1 1006



17 CHAPTER

Pensions and Other Postretirement Benefits 1008

Part A: The Nature of Pension Plans 1010

Defined Contribution Pension Plans 1012

Defined Benefit Pension Plans 1013

Pension Expense—An Overview 1014

Part B: The Pension Obligation and Plan Assets 1015

The Pension Obligation 1015

Accumulated Benefit Obligation 1015

Vested Benefit Obligation 1016

Projected Benefit Obligation 1016

Illustration Expanded to Consider the Entire Employee Pool 1021

Pension Plan Assets 1021

Reporting the Funded Status of the Pension Plan 1023

Part C: Determining Pension Expense 1023

The Relationship between Pension Expense and Changes in the PBO and Plan Assets 1023

Components of Pension Expense 1025

Income Smoothing 1027

Part D: Reporting Issues 1029

Recording Gains and Losses 1029

Recording the Pension Expense 1031

Recording the Funding of Plan Assets 1032

Comprehensive Income 1033

Income Tax Considerations 1034

Putting the Pieces Together 1035

Decision Makers' Perspective 1036

Settlement or Curtailment of Pension Plans 1036

Concept Review Exercise: Pension Plans 1037

Part E: Postretirement Benefits Other Than Pensions 1039

What Is a Postretirement Benefit Plan? 1040

Postretirement Health Benefits and Pension Benefits Compared 1040

Determining the Net Cost of Benefits 1041

Postretirement Benefit Obligation 1042

Measuring the Obligation 1042

Attribution 1043

Accounting for Postretirement Benefit Plans Other Than Pensions 1043

A Comprehensive Illustration 1045

Decision Makers' Perspective 1046

Concept Review Exercise: Other Postretirement Benefits 1047

Appendix 17: Service Method of Allocating Prior Service Cost 1050

Questions For Review of Key Topics 1051

Brief Exercises 1052

Exercises 1053

CPA and CMA Review Questions 1062

Problems 1064

Broaden Your Perspective 1071

Air France–KLM Case 1076



18 CHAPTER

Shareholders' Equity 1078

Part A: The Nature of Shareholders' Equity 1079

Financial Reporting Overview 1080

Paid-in Capital 1081

Retained Earnings 1081

Treasury Stock 1082

Accumulated Other Comprehensive Income 1082

Reporting Shareholders' Equity 1083

The Corporate Organization 1085

Limited Liability 1086

Ease of Raising Capital 1086

Disadvantages 1086

Types of Corporations 1086

Hybrid Organizations 1087

The Model Business Corporation Act 1087

Part B: Paid-In Capital 1088

Fundamental Share Rights 1088

Distinguishing Classes of Shares 1088

Typical Rights of Preferred Shares 1089

Is It Equity or Is It Debt? 1090

The Concept of Par Value 1091

Accounting for the Issuance of Shares 1091

Shares Issued For Cash 1091

Shares Issued for Noncash Consideration 1092

More Than One Security Issued for a Single Price 1092

Share Issue Costs 1093

Concept Review Exercise: Expansion of Corporate Capital 1094

Share Buybacks 1095

Decision Maker's Perspective 1095

Shares Formally Retired or Viewed as Treasury Stock 1096

Accounting for Retired Shares 1097

Accounting for Treasury Stock 1098

Resale of Shares 1099

Concept Review Exercise: Treasury Stock 1099

Part C: Retained Earnings 1102

Characteristics of Retained Earnings 1102

Dividends 1102

Liquidating Dividend 1102

Retained Earnings Restrictions 1103

Cash Dividends 1103

Property Dividends 1104

Stock Dividends and Splits 1104

Stock Dividends 1104

Stock Splits 1106
 Stock Splits Effected in the Form of Stock Dividends
 (Large Stock Dividends) 1106
 Decision Maker's Perspective 1108
Concept Review Exercise: Changes in Retained Earnings 1109
 Appendix 18: Quasi Reorganizations 1113
Questions For Review of Key Topics 1115

Brief Exercises 1115
Exercises 1117
CPA and CMA Review Questions 1124
Problems 1126
Broaden Your Perspective 1131
Air France–KLM Case 1137
CPA Simulation 18–1 1137

4 Additional Financial Reporting Issues

19 CHAPTER Share-Based Compensation and Earnings Per Share 1138



Part A: Share-Based Compensation 1139

Stock Award Plans 1140
 Stock Option Plans 1141
 Expense—The Great Debate 1141
 Recognizing the Fair Value of Options 1143
 When Options are Exercised 1145
 When Unexercised Options Expire 1145
 Plans with Graded Vesting 1147
 Plans with Performance or Market Conditions 1149
 Employee Share Purchase Plans 1150
 Decision Makers' Perspective 1151

Concept Review Exercise: Share-Based Compensation Plans 1151

Part B: Earnings Per Share 1152

Basic Earnings Per Share 1153
 Issuance of New Shares 1153
 Stock Dividends and Stock Splits 1154
 Reacquired Shares 1155
 Earnings Available to Common Shareholders 1156
 Diluted Earnings Per Share 1157
 Potential Common Shares 1157
 Options, Rights, and Warrants 1157
 Convertible Securities 1159
 Antidilutive Securities 1162
 Options, Warrants, Rights 1162
 Convertible Securities 1163
 Order of Entry for Multiple Convertible Securities 1164

Concept Review Exercise: Basic and Diluted EPS 1165

Additional EPS Issues 1166
 Components of the "Proceeds" in the Treasury
 Stock Method 1166
 Contingently Issuable Shares 1168
 Summary of the Effect of Potential Common Shares on
 Earnings Per Share 1169

Actual Conversions 1170
 Financial Statement Presentation of Earnings Per
 Share Data 1170

Decision Makers' Perspective 1173

Concept Review Exercise: Additional EPS Issues 1174

Appendix 19A: Option-Pricing Theory 1177
 Appendix 19B: Stock Appreciation Rights 1179
Questions For Review of Key Topics 1181

Brief Exercises 1182

Exercises 1183

CPA and CMA Review Questions 1189

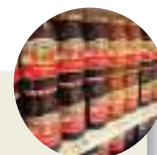
Problems 1191

Broaden Your Perspective 1197

Air France–KLM Case 1204

CPA Simulation 19–1 1205

20 CHAPTER Accounting Changes and Error Corrections 1206



Part A: Accounting Changes 1208

Change in Accounting Principle 1209
 Decision Makers' Perspective—Motivation
 for Accounting Choices 1209
 The Retrospective Approach: Most Changes
 in Accounting Principle 1210
 The Prospective Approach 1214
 Change in Accounting Estimate 1216
 Changing Depreciation, Amortization,
 and Depletion Methods 1217
 Change in Reporting Entity 1219

Error Correction 1220

Concept Review Exercise: Accounting Changes 1221

Part B: Correction of Accounting Errors 1222

Prior Period Adjustments 1222

Error Correction Illustrated 1224

Error Discovered in the Same Reporting Period That It Occurred 1224
 Error Affecting Previous Financial Statements, but Not Net Income 1224
 Error Affecting a Prior Year's Net Income 1225

Concept Review Exercise: Correction of Errors 1229

Questions For Review of Key Topics 1231

Brief Exercises 1232

Exercises 1233

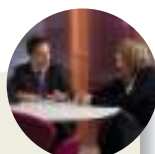
CPA and CMA Review Questions 1240

Problems 1242

Broaden Your Perspective 1250

CPA Simulation 20–1 1254

21 CHAPTER The Statement of Cash Flows Revisited 1256



Part A: The Content and Value of The Statement of Cash Flows 1258

Decision Makers' Perspective—Usefulness of Cash Flow Information 1258

Cash Inflows and Outflows 1258

Role of the Statement of Cash Flows 1259

The Importance of Cash Flows in an Economic Decline 1261

Cash and Cash Equivalents 1261

Primary Elements of the Statement of Cash Flows 1262

Preparation of the Statement of Cash Flows 1268

Appendix A: Derivatives A-0

Appendix B: Dell Annual Report B-1

Appendix C: IFRS Comprehensive Case C-1

Glossary G-0

Photo Credits C-1

Index I-1

Present and Future Value Tables P-1

Part B: Preparing The SCF: Direct Method of Reporting Cash Flows From Operating Activities 1271

Using a Spreadsheet 1271

Income Statement Accounts 1273

Balance Sheet Accounts 1280

Concept Review Exercise: Comprehensive Review 1289

Part C: Preparing The SCF: Indirect Method of Reporting Cash Flows From Operating Activities 1293

Getting There through the Back Door 1293

Components of Net Income That Do Not Increase or Decrease Cash 1294

Components of Net Income That Do Increase or Decrease Cash 1294

Comparison with the Direct Method 1295

Reconciliation of Net Income to Cash Flows from Operating Activities 1296

Decision Makers' Perspective—Cash Flow Ratios 1298

Appendix 21A: Spreadsheet for the Indirect Method 1300

Appendix 21B: The T-Account Method of Preparing the Statement of Cash Flows 1304

Questions For Review of Key Topics 1306

Brief Exercises 1307

Exercises 1308

CPA and CMA Review Questions 1318

Problems 1320

Broaden Your Perspective 1333

Air France–KLM Case 1339

CPA Simulation 21–1 1339